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America's slowing economy

Vietnam's booming one

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The beginning of the end of Castro

Women's and men's brains

The war beyond the war

ONLINE FEATURES

Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

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Economist Intelligence Unit
Economist Conferences
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Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences
Economist Diaries and Business Gifts

Print Edition August 5th 2006

On the cover
The war behind the war involves Iran and America as well as Lebanon and Israel: leader

Previous print editions

Jul 29th 2006
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Jul 1st 2006

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The world this week

Politics this week
Business this week

Leaders

The Middle East
The war beyond the war

The Federal Reserve
The perils of pausing

Carbon offsets
Sins of emission

The Caucasus
Keeping Georgia on our minds

La différence
How women won the sex war

Letters

On navigation systems, economic models, South Africa, Israel and Lebanon, Venezuela, Shamil Basayev, English

Special Report

The Lebanese crisis
Trying in vain to find a way out

France and Lebanon
Once again, a leading light

The Arab world
A surge of anger

Iran
The regional manipulator

United States

Middle East policy
To Israel with love

Anti-Semitism
Mad Mel

Cuban-Americans
Let's ban a book on Cuba

Anti-dumping
Shrimp cocktail

The wilderness
Where bike meets boot

Washington's governor
Recovering from a bitter victory

The Arkansas governor's race
Cycling, and recycling, for votes

The Americas

Cuba
Fading away

Colombia
A presidential encore

Canadian citizenship
I'm a lumberjack, and you're not

Mexico's contested election
After maths

Asia

Business

Emissions offsets
Upset about offsets

Retailing
Heading for the exit

Japan's food industry
Surf 'n' turf

Advertising
On the spot

Picture messaging
Lack of text appeal

AOL
You've got mail—for nothing

Pharmaceuticals
Pfizer's latest remedy

Face value
From online to helpline

Special Report

Retailing in China
Ready for warfare in the aisles

Finance & Economics

Emerging markets and interest rates
Bernanke has it easy

Monetary policy in the euro area
Bank on it

Hedge funds and exchanges
Joining the establishment

Deutsche Bank
What goes up must come down

Chinese M&A
Playing at home

Infrastructure finance in India
Shares and shovels

Economists' blogs
The invisible hand on the keyboard

Economics focus
Least favoured nation

Science & Technology

Differences between the sexes
The mismeasure of woman

Books & Arts

New fiction
Atonement

Al-Qaeda
All about Osama

Nelson Mandela
Madiba revisited

Education in medieval Britain
Not what it used to be

British royal history
Queen be

Advertisement

Vietnam
Good morning at last

Australia
Once more unto the breach

China
Something new

Kazakhstan
The revolt in Almaty

Sri Lanka
Broken pieces

Hong Kong's culture of defenestration
Hard rain

Middle East & Africa

Congo
After the poll

Sudan
An island unto itself

South Africa
Fear factor

East Africa
Swimming against the tide

Europe

Georgia and Russia
Fighting talk casts a summer shadow

Ukraine's political crisis
Oranges and apples?

Turkish anti-Semitism
An unfamiliar spectre rises

Business and politics in Germany
When nettles aren't grasped

Deregulation in Italy
A logjam breaks

Old and new information tricks
Disinformation

Britain

Foreign policy
The poodle's dilemma

Interest rates
A surprise increase

Illicit drugs
Reefer madness

Nuclear waste
The long view

Company pensions
Running to stand still

Art
Hidden treasures

Churchmen and the environment
A new testament

Specialist schools
A question of trusts

Orpheus Chamber Orchestra
Headless

Obituary

Ta Mok

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Australia

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Trade

Emerging-Market Indicators

Overview

Exports

Economy

Financial markets

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Jobs
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The World Intellectual Property Organization (WIPO) , located....

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Business Opportunity - WSI Internet Start Your Own Busines....

Tenders
WSI Internet - Start Your Own Business
Business Opportunity - WSI Internet Start Your Own Business! Profit....

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Director, Office of Evaluation (OEDE)
The World Food Programme (WFP), the wor....

Tenders
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Politics this week

Aug 3rd 2006
From The Economist print edition

Western powers struggled, and continued to fail, to bring about a ceasefire in **Lebanon**, while **Israel** continued to hit what it said were strongholds of the Hizbullah militia across the country. An attack on the town of Qana, one such Hizbullah stronghold, killed at least 28 people, more than half of them children, causing an international outcry that increased the pressure on Israel and its American ally to agree to an unconditional ceasefire. Israel insisted that Hizbullah should first disarm. See article

Getty Images

In a leaked memorandum, the outgoing British ambassador to **Iraq** said that "the prospect of a low-intensity civil war and a de facto division of Iraq is probably more likely" than a stable democracy.

More than 30 ministers resigned from the UN-backed transitional government in **Somalia** over the prime minister's refusal to talk to the Council of Islamic Courts. For their part, the Islamists will not talk to the government as long as Ethiopian troops remain in the country.

The first democratic election in **Congo** for 46 years passed off fairly well on July 30th. The incumbent, President Joseph Kabila, is expected to win, but official results will not be out for several weeks. See article

Ngozi Okonjo-Iweala was removed from her post as head of **Nigeria's** economic-reform team. Previously a campaigning finance minister, she was credited with leading an anti-corruption drive and securing debt relief until unexpectedly becoming foreign minister last month. This latest move reinforces fears that economic reforms are faltering.

Ukraine's somersault

In an apparent resolution of a long political crisis, **Ukraine's** President Viktor Yushchenko agreed to nominate his pro-Russian rival, Viktor Yanukovich, as prime minister. See article

Turkey named General Yasar Buyukanit as the new head of its armed forces, ending speculation that the ruling Justice and Development Party, which traces its roots to political Islam, would try to block his appointment. General Buyukanit is expected to take a tough approach in maintaining Turkey's secularism. See article

The unemployment rate in the **euro area** fell to 7.8% in June, it lowest level in five years.

After weeks of protests against the proposal, **Italy's** parliament voted for measures to end protectionism in jobs ranging from taxi-drivers to lawyers. The average Italian family is expected to save *euro*1,000 ($1,270) a year because of the deregulation. See article

Warm words in California

AP

Tony Blair visited **California**, where he signed an agreement with the state's governor, Arnold Schwarzenegger, to collaborate on tackling global warming. Mr Schwarzenegger, a Republican, criticised the federal government for not taking strong action on the issue, a position that will do him no harm as he starts his re-election campaign. See article

Polling indicated a close finish in Connecticut's Democratic primary for senator on August 8th. **Joe Lieberman**, the incumbent, has said he will run as an independent in November's mid-term election, potentially fracturing the Democratic vote, if he loses the primary to an anti-war candidate, Ned Lamont.

A marine who is under investigation for taking part in the alleged murder of civilians in the Iraqi town of **Haditha** last November filed a defamation lawsuit against John Murtha, a veteran Democratic congressman and hawk who no longer supports the Bush administration on Iraq, for comments he made about the incident.

Andrew von Eschenbach was grilled by Democrats in Congress at his nomination hearing for commissioner of the **Food and Drugs Administration**. Mr von Eschenbach, who is acting head of the agency, was asked why the FDA had suddenly announced it might approve a “morning-after” contraceptive pill, which has been dogged by controversy since 2003.

A pause for breath

For the first time in his 47-year rule Cuba's **Fidel Castro** handed over power temporarily to his brother Raúl, the defence minister. Fidel claimed his health was stable after emergency surgery to halt intestinal bleeding. Although the news caused some anxiety in Havana, Cuban exiles celebrated in Miami. Mr Castro turns 80 on August 13th. See article

Thousands of supporters of Andrés Manuel López Obrador, who is contesting the results of **Mexico's** presidential election, occupied Mexico City's main square and held sit-ins on main roads in the capital in support of his demand for a full ballot recount. See article

Argentina's Congress voted to grant the executive branch the right to alter the national budget however it chooses, so long as the total amount of spending is not changed. The decision strengthens the president's already robust powers at the expense of the weak legislature.

Fifteen soldiers died in an ambush in north-eastern **Colombia** and a civilian was killed by a car bomb in Bogotá, the capital. The attacks came a week before the inauguration of Álvaro Uribe to a second term as president and are thought to be the work of the FARC, the main rebel group. See article

Another war

Fresh fighting erupted in the port city of Trincomalee in **Sri Lanka's** north-east as thousands of people reportedly fled the area. The conflict between the army and Tamil Tiger rebels has intensified recently and the country is sliding ever-closer to civil war. See article

NATO took command of operations in southern **Afghanistan** and claimed to have killed dozens of Taliban fighters in the region. At least four troops, three of them British, were also killed.

Reuters

The top diplomats of **India** and **Pakistan** met for the first time since seven bombs killed more than 180 people in Mumbai last month, and vowed that the peace process would not be disrupted.

Three policemen were killed by a bomb in **Thailand's** rebellious south. The explosion came the day after suspected Muslim separatists carried out dozens of co-ordinated bomb attacks using small devices, which injured three people.

Australia's prime minister, John Howard, confirmed that he intends to campaign for a fifth term at the next general election, expected next year. His decision ends speculation about his likely successor, but will disappoint Peter Costello, the finance minister, who was tipped to get the job. See article

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Business this week

Aug 3rd 2006
From The Economist print edition

AOL, Time Warner's internet division, said it would provide free software, e-mail and other services to broadband customers as part of its strategy to boost advertising. Time Warner hopes people will visit AOL even when they move to other firms' broadband. Analysts wondered if this would be enough to get AOL growing: its advertising revenue in the second quarter was 40% higher than a year ago, but that was more than offset by lower revenue from subscribers, whose number has fallen by 30% since 2002. See article

Vonage issued its first quarterly statement since its disastrous stockmarket debut in May. The company reported a net loss of $74m as rivals piled into the business of offering phone calls over the internet, in which Vonage was an innovator. It has spent an ever-greater amount on marketing—$90m in the second quarter—to keep up. Since flotation, its share price has fallen by more than half.

Verizon Communications'chief executive all but ruled out buying the 45% of its profitable subsidiary, **Verizon Wireless,** that is held by **Vodafone** within the next few years. The admission came as Verizon Communications reported a steep fall in net profit for the second quarter.

In Serbia's biggest privatisation, **Mobi 63**, the country's second-biggest mobile-phone operator, was sold to **Telenor**, a Norwegian operator, for $1.9 billion after a nifty government auction.

Nothing to smile about

Eastman Kodak reported poor sales of consumer digital equipment (and its seventh straight quarterly loss) and said that it would outsource the manufacture of its cameras, a tradition the company traces back to 1888, to Singapore's Flextronics. An icon of photography in the 20th century, Kodak is undergoing a hard time as it switches away from film to digital media and graphic imaging.

Japan Post published details of its planned privatisation, which is due to start in October 2007 and take ten years to complete. The company will be split into four parts: a postal-savings bank, a life insurer, a mail-delivery business and a post-office services unit. The bank's assets alone total ¥227 trillion ($2 trillion).

E.ON, a German utility, received a setback to its *euro*27 billion ($34 billion) offer to buy Spain's **Endesa**. Spanish regulators imposed conditions on a takeover, including the sale of some assets on the ground of energy security. German officials cried foul, insisting the conditions were illegal under European Union competition regulations. In a further test of those regulations, Iberdrola, a rival to Endesa, said it would appeal against the EU's approval of E.ON's bid.

Using a new law, a French court granted **Eurotunnel** its request for protection from a group of disgruntled bondholders unhappy with the restructuring of its £6.2 billion ($11.6 billion) debt. The ruling gives the operator of the tunnel linking Britain and France a six-month period to push through its plan.

Gone, but not forgotten

An air of finality hung over the saga of **Yukos**, which was formally declared bankrupt by a judge in Moscow. Once Russia's biggest oil company, its fall from political grace led to the forced sales of its biggest assets, the trial and jailing of its boss and the flight of other managers, who still claim Yukos is solvent.

The mining industry was galvanised by the latest efforts at consolidation. **Inco**, a Canadian miner,

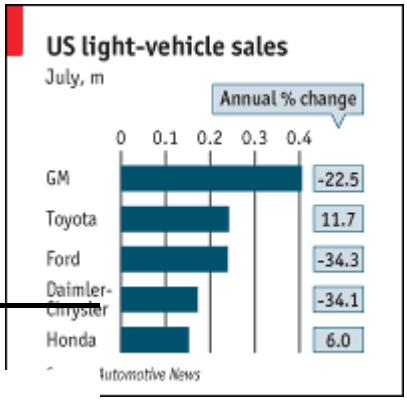
admitted failure in its bid to buy **Falconbridge**, a compatriot, leaving the way open for a takeover of the latter by Switzerland's **Xstrata**. Inco's defeat unravels **Phelps Dodge's** plan to buy a combined Inco and Falconbridge and thus create one of the world's biggest mining firms.

Amid a batch of statistics forecasting a rise in inflationary pressures, the **European Central Bank** lifted its key interest rate by one-quarter of a percentage point to 3%. Surprisingly, the **Bank of England** also raised its key rate by the same amount to 4.75%, the first change for 12 months. See article

Hank Paulson made his first speech as America's treasury secretary. He was more frank than expected about the country's budget deficit, the reform of entitlement programmes and the stagnation of the living standards of middle-income Americans.

More Motown blues

America's three biggest carmakers saw a slump in sales in the United States during July as demand fell for petrol-thirsty SUVs and rose for fuel-efficient cars. Japan's carmakers fared rather better: **Toyota** outsold **Ford** for the first time, putting it in second place behind General Motors. Meanwhile, Ford reported a second-quarter loss of $254m, twice what it had previously said, owing largely to extra pension costs caused by job cuts.



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The Middle East

The war beyond the war

Aug 3rd 2006
From The Economist print edition

The Lebanon war is also about America, Iran and the Palestinians

Getty Images

IN CHESS they call it a *Zugzwang*, the position that arises when your next move, any next move, is liable to lead to disaster. That is roughly where Ehud Olmert finds himself this week. If Israel's prime minister ceases fire now, Hizbullah will claim that it has won simply because, after three weeks of pounding by the regional superpower, its men were still putting up a fight and firing their rockets into Israel's towns and villages. But if Mr Olmert chooses instead to push deeper into Lebanon, he risks sinking Israel in a costly guerrilla war like the one it thought it had ended by leaving Lebanon six years ago.

To avoid these risks, Mr Olmert is therefore aiming for a middle way that may not exist. He said on August 2nd that Israel would continue to push into southern Lebanon until a “strong” international force arrives to finish the job of disarming Hizbullah. So simple—and so blithe. Mr Olmert was speaking on a day when Hizbullah fired a record number of rockets into Israel, at a moment when no international force existed, and when the plans to create one remained a study in vagueness (see article). Who would put up the troops? Would they really be willing or able to disarm Hizbullah by force? If not by force, under what sort of deal? Amid the unknowns, the nearest thing to a certainty was that the war would end as messily as it began, with no clear win for either side.

Iran's proxy, and America's

It is sometimes no bad thing to end with a draw. Lopsided victories, like the ones Israel won in 1948 and 1967, can leave a residue of hubris on one side and shattered pride on the other that block peacemaking for decades. By contrast, the war of 1973, which both Israel and Egypt claimed to have won, restored Egyptian honour and persuaded Israel that it was worth exchanging the Sinai peninsula for peace with its strongest neighbour. The Palestinian *intifada* of the late 1980s also ended in a draw of sorts. The Palestinians could not push Israel out of the West Bank and Gaza but nor could Israel suppress the Palestinian fever for an end to occupation. This was one of the things that helped convince Yitzhak Rabin of the need to give Yasser Arafat the embryo of what should have become an independent state in the West Bank and Gaza.

The present war is one of the bitterest yet between Israel and the Arabs. Never before have Israelis faced such a sustained, indiscriminate bombardment in their own homes; by comparison, Saddam

Hussein's Scud missiles of 1991 were a passing squall. And not since its independence war has Israel felt entitled to clear the battlefield by ordering hundreds of thousands of Arab civilians to flee their houses and villages, as it has these past weeks in Lebanon. Despite the hundreds of dead, most of them Lebanese civilians, this has not yet been one of the more lethal regional wars. Yet it has already added disproportionately to the brimming pot of hatred.

For all the blood and anger, might this war lead to another reweighing of costs and benefits of the sort that has unblocked diplomacy after previous hard-fought draws between Israel and its neighbours? Much will depend on the ingenuity of mediators. But the omens, this time, are not promising.

This is not because of the complexity of the quarrel between Israel and Lebanon, but for the opposite reason. These two countries do not in fact have much to quarrel about. There is between them no painful land-for-peace deal that has to be made, of the sort that Israel made with Egypt and must one day make with the Palestinians. (The “disputed” scrap of land known as the Shebaa Farms is at most a pretext Hizbullah uses to justify its fighting.) Indeed, a case can be made that this particular conflict is not primarily between Israel and Lebanon at all so much as it is between Israel and Iran, Hizbullah's mentor—and between America and Iran. That makes it much harder to resolve, not least because the superpower, so far from being a mediator, is in effect a protagonist, competing with Iran for domination of the post-Saddam Middle East, and to some extent tempted in this war to use Israel as a proxy.

This is a dreadful new turn. The century-long conflict between Zionism and the Arabs of Palestine has been hard enough to settle on its own, without additional global and regional rivalries superimposed. The cold war prolonged the fight in Palestine. It is no coincidence that some of the most promising peacemaking came after the Soviet Union stopped competing with America to be the dominant power in the Middle East. Now the core conflict is once again becoming entangled in a bigger one—perhaps even more dangerous this time because Iran is more eager than were the secular Arab states of the 1950s and 1960s to put Islam at the centre of the anti-Zionist cause.

From Iran's point of view, Hizbullah's audacity against Israel is a magnificent advertisement for its particular brand of Shia piety. This profoundly discomfits those Arab allies of America such as Saudi Arabia, which aspires to lead Sunni Islam but is made to look feeble whenever it sits on the sidelines during an Arab-Israeli war. It unsettles Egypt and Jordan, which have made their unpopular peaces with Israel. And in the Palestinian territories it fortifies Hamas, which finds religious objections to peace with Israel, at the expense of the more accommodating secularists of Fatah. Even al-Qaeda, which detests Shias and murders them in Iraq, has felt obliged this week to join the fray. Ayman al-Zawahiri, Osama bin Laden's deputy, popped up from his cave to say that Iraq, Afghanistan, Lebanon and Palestine were now just one seamless front of warfare between Islam and the Jews and crusaders.

Only disconnect

If the Lebanon war is not just a scrap between neighbours but also a proxy war between Iran and America, how is it going to be possible to bring about a durable peace once it ends? One idea gathering pace among some American foreign-policy realists—in opposition to the neoconservatives—such as Henry Kissinger is to seize this opportunity to bring about the “grand bargain” that has been mooted for years between America and Iran. Since all the region's quarrels—Iran's bomb, Iraq's future, the isolation of Syria, the Hizbullah state inside Lebanon and the unrequited cause of the Palestinians—are interlinked, why not think now about starting to sort out the lot of them?

It certainly would not hurt, after a week in which the Security Council has again told Iran to stop enriching uranium, for America to emphasise again the political and economic benefits Iran stands to gain by complying with this demand. America and Iran must talk. All the same, a bargain this grandiose may be beyond the reach of even the most creative diplomacy.

So it may be more sensible to disconnect some of the pieces than to join too many together. In particular, the outlook for the Palestinians would be less bleak if sundry outsiders did not periodically hijack their cause to mobilise Muslim emotions against Israel, America or both. Between Israel and the Palestinians there is probably still a deal to be made if both show enough courage and generosity. In the end, it is only Israel that can give the Palestinians their state, and only the Palestinians can give Israel the legitimacy it craves in the Middle East. In a region of conflict, it is these two peoples whose interests coincide most closely. Solving that problem remains the best of all ways to promote a wider peace.

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The Federal Reserve

The perils of pausing

Aug 3rd 2006
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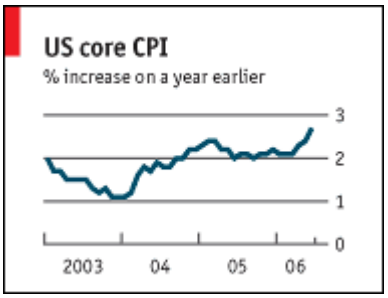
America's economy is slowing, but the Fed should still raise interest rates next week



WHEN Ben Bernanke succeeded Alan Greenspan as the chairman of America's Federal Reserve earlier this year, *The Economist*'s cover illustration depicted Mr Greenspan as a relay runner, passing on a baton, in the form of a lighted stick of dynamite, to his successor. Mr Bernanke, this newspaper suggested, was inheriting an economy in much worse shape than popularly assumed (see article).

Six months later, the fuse has burned low, with growth slowing and inflation on the rise. Output grew at an annual rate of just 2.5% in the second quarter of the year, well below capacity. And the speed with which the housing market is cooling suggests that a sharper slowdown may lie ahead. A growing number of commentators are now talking about a recession next year. At the same time, inflation is higher than America's central bankers would like, and increasing. The price gauge that they watch most closely, the deflator for personal consumption expenditure excluding food and energy, went up by an annualised 2.9% between April and June, far above their preferred range of 1-2%. Well over half the components of the consumer-price index are rising at an annual rate above 3%.

This combination of strengthening inflation and flagging growth poses an awkward dilemma for Mr Bernanke and his colleagues, who next gather on August 8th. After raising short-term interest rates at 17 consecutive meetings, America's central bankers have brought the federal funds rate to 5.25%. Monetary policy is no longer loose. By some measures it is a little restrictive. And since higher interest rates take several months to work their way through the economy, the impact of some of the Fed's earlier actions is yet to be felt. If Mr Bernanke and his colleagues raise rates too far, they risk pushing a faltering economy into recession. But if they stop tightening policy too soon, inflation may get out of hand.

Thanks to the weak growth figures, financial markets are betting that the central bankers are more likely to stand pat next week than raise rates again. That would be a mistake. America's economy may be losing steam, but the dangers of rising inflation outweigh those of slowing growth. If Mr Bernanke is prudent, he will increase rates once again.

For a start, the recent deceleration should not be exaggerated. Growth has indeed slowed abruptly, but from a blistering, unsustainable pace—5.6%, at an annualised rate, in the first three months of the year. Some of the second quarter's weakness, especially in firms' investment and in exports, may prove temporary. The rest of the world is still growing healthily. In the housing market, it is true, things are likely to get worse. Residential construction is falling, property prices are flat and the number of unsold homes is rising fast. But in the absence of a full-blown collapse of house prices—which, though possible, is by no means assured—America is a long way from recession. A period of sluggish growth is a far more likely outcome. And with inflation straining at the leash, that is exactly what the economy needs. Moreover, it needs it to last much longer than many people realise.

Unwinding the excesses

An extended diet of sub-par growth is essential to quell rising price pressure. It is also the only way to unwind the imbalances—households' heavy debts and negative saving rate, the vast current-account deficit—that are the legacy of Mr Greenspan's loose monetary policy. Few in America like to admit this. Even the Fed foresees only a couple of quarters of sluggish growth this year before the economy bounces back in 2007 with inflation declining nonetheless. That makes no sense. Unless demand growth stays

weaker for longer than they now expect, the central bankers will neither get the economy back into balance nor quash inflation.

And the need to get a grip on price pressure is becoming more urgent. Every measure of inflation has been too high for months. But many discounted the risks involved, largely because productivity growth was strong and wage pressure weak. If firms were becoming ever more efficient and wages were stagnant, the chances of a nasty wage-price spiral seemed low. Recent revisions to America's national accounts, however, suggest less room for complacency. Productivity growth seems to have been lower and labour costs higher than initially thought. The new figures say wages are accelerating: America's total wages and salaries rose by 6.8% in the year to the second quarter of 2006, the most in six years.

Add together the need for a period of slower growth and the greater danger from inflation, and the unavoidable conclusion is that interest rates must go up again. After 17 rises in a row, Mr Bernanke may be tempted to call for a time-out. It is a temptation he should resist.

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Carbon offsets

Sins of emission

Aug 3rd 2006
From The Economist print edition

The idea of offsetting carbon emissions is sound in theory, if not yet in practice

Get article background

THE sale of indulgences by the Catholic church in the early 16th century, whereby people could, in effect, purchase forgiveness of past sins by handing over enough money, was condemned by Martin Luther and other reformers. Today, some environmentalists are denouncing the "offsetting" of carbon emissions in similar terms. A company that wants to declare itself "carbon neutral" calculates how many tonnes of carbon it emits, and then offsets the emissions by paying someone else not to emit that amount of carbon on its behalf. Just as Luther criticised indulgences, critics of offsetting argue that the ability to buy retrospective forgiveness for sins of emission is no substitute for not sinning in the first place.

Carbon offsets have two main purposes. One, as with indulgences, is to assuage guilt. Carbon offsetting allows consumers to quell their eco-guilt even as they jet off to distant climes on holiday, and drivers of sports-utility vehicles to argue that they have atoned for the emissions produced by their gas-guzzling cars. A second purpose is image-polishing: companies that declare themselves carbon neutral may well have public-relations as well as environmental benefits in mind.

To fulfil those purposes, carbon offsets do need to reduce carbon emissions. Existing schemes are far from perfect. One popular sort involves planting trees, which remove carbon from the atmosphere as they grow; but this approach is now somewhat discredited, since the carbon may be released again when the trees are cut down. Another problem with offset schemes is the lack of standards: can you really trust those who promise to eliminate emissions elsewhere on your behalf? Then there is the problem of "additionality": would the emissions in question have been eliminated anyway, or is the reduction additional? Since offsetting is done on a voluntary basis, unlike the mandatory carbon-trading systems that have been imposed on some industries in some countries, such doubts may put people off doing it altogether. After all, only wide-ranging, compulsory schemes will make a real difference in reducing emissions and minimising climate change; the odd bit of offsetting here and there will not.

Despite such flaws, however, the idea of carbon offsets is a good one. Establishing markets in which carbon emissions can be traded and offset is a good idea, since market forces then provide financial incentives for people to find the cheapest ways to reduce or eliminate emissions. The lack of standards is also being addressed. Various bodies are creating standards and inspection regimes that will allow buyers of carbon offsets to feel confident that they really are getting what they pay for (see article). And many

firms are embracing voluntary offsetting now in the expectation that compulsory carbon trading will soon be imposed upon them anyway.

The right way to not do something

Yet as the nascent carbon-offsetting industry starts to take shape, a new problem is emerging. Some of the non-governmental organisations that are drawing up carbon-offset standards require emissions to be cut in particular ways: after due consultation with local people, for example, or using particular favoured technologies. Such considerations are irrelevant: the only thing that should matter in offset schemes is that emissions should be cut. Politicising offsets risks discrediting an approach that deserves to be taken seriously. And that really would be a sin.

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The Caucasus

Keeping Georgia on our minds

Aug 3rd 2006
From The Economist print edition

Be warned: another flare-up in the Caucasus would be bad news for everyone

FIDDLY little places with tragic histories; ancient hatreds exploited by foreign powers; a sudden blunder into war. That is the story in Lebanon, a conflict that now commands most of the world's concern. But it also describes two lesser-known disputes in nearby Georgia—tales that may yet have a Lebanese-style ending. It would be wise to give those Georgian conflicts some attention now, before the worst happens.

Beautiful, impoverished Georgia is home to two of the ex-Soviet Union's so-called “frozen conflicts”: territorial disputes left over from nasty wars that erupted after the Soviet empire collapsed. Both Abkhazia on the Black Sea (once a fabled holiday resort, now near-destitute) and South Ossetia fought their way to de facto independence in the early 1990s. There are differences between them, but they have two big things in common. One is that they maintain their unrecognised netherworld status only because of Russia's support. The other is that, through a mixture of international indifference, Kremlin provocation and cock-eyed Caucasian machismo, both may at any moment devolve from uneasy truce to renewed fighting (see article). Bloodshed in either or both would be disastrous not only for them and little Georgia. It would also further destabilise a region already wracked by war and militant Islamism. It would jeopardise a new energy link between the Caspian Sea and the Mediterranean. And it would undermine hopes that democracy can reach the misruled states around Russia's borders—a hope that, with the exception of the Baltic nations, Georgia probably comes closest to realising.

With its own secessionist problems, Russia might seem to have most to lose, after Georgia, from a new crisis in the Caucasus. It ought also to have a high regard for the principle of states' territorial integrity. But that rational concern—and many Russians' affection for Georgia as a land of wine and sun—has been outweighed in the mind of President Vladimir Putin by something else. Or rather, someone: Mikhail Saakashvili, Georgia's president since the “rose revolution” of 2003, has striven to re-orient his country towards the West. The Kremlin's loathing of him has led to a sort of undeclared war, in which the two breakaway enclaves are fronts. The Russians want to stop him taking Georgia into NATO, and would ideally like to force him from power.

His friend George

Small countries need big friends. Estranged from Georgia's erstwhile master, Mr Saakashvili has striven

to ingratiate himself with America. The goodwill is mutual: at the White House last month, George Bush described him as “my friend”, quipping that he had “Georgia on [his] mind”. In fact, Mr Saakashvili's woes are unlikely to bulk large in Russian-American diplomacy. But Mr Bush—and European leaders, who tend to be less forthright with the Kremlin because they need Russian energy—must tell Mr Putin they care about the Caucasus. Russian policy towards Georgia will not change just because outsiders want it to; but a bit of ear-bending in the context of issues such as Russia's accession to the World Trade Organisation, or trade relations with the European Union, might help the Kremlin see its own interests more clearly. One big task is to craft genuinely even-handed peacekeeping forces that can take the place of the Russian-dominated arrangements that now prevail in both enclaves.

However, outside support for Georgia should not mean backing everything Mr Saakashvili does. He is a young president in a hurry, with a tendency to overplay his hand. In part, that is because Georgia's problems are pressing. Georgians worry that the “frozen” conflicts are not really frozen at all, and that, with Russian connivance, the enclaves are in fact in danger of slipping away for good. But Mr Saakashvili would strengthen Georgia's hand if he spent less time considering how to force them back and more time trying to lure them back. He must address the disappointments of his presidency, consolidate his country's fragile growth and address the still prevalent abuses such as police brutality. His recruitment of some sound advisers from Estonia and elsewhere is a promising sign, but he needs to act on their counsel. Only by becoming a prosperous democracy will Georgia have any real chance of attracting home its wayward territories—and of bringing long-term stability to the combustible Caucasus.

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La différence

How women won the sex war

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Larry Summers may well have been right, but men are done for anyway

ONE of last year's better entertainments was the Larry Summers show. The row over whether Mr Summers, the then president of Harvard University, was right or wrong to say that natural ability may be one of the reasons why there are fewer female than male maths professors at Harvard brought pleasure to politically correct and incorrect alike. It confirmed the prejudices of both about each other, and led to the downfall of a man beloved by neither.

Mr Summers may have been right. In most intellectual areas, such as vocabulary and verbal reasoning, the differences between men and women are statistically insignificant. But the long tail of mathematical genius does tend to be male, along with higher rates of idiocy and masturbation. While women show less mathematical brilliance than men, their scores are better in some verbal skills (see article).

These differences may or may not be innate, but the argument anyway misses the point. The interesting question is not whether men are more likely to be weirdly good at maths than women are, but whether the things that men are good at are more or less useful than the things that women are good at. And the answer, in the rich world at least, is no.

Technology and globalisation are undermining the usefulness of male skills. Take map-reading. The female tendency to call for five right turns while holding the map upside down, playing “I spy” with the children and remarking on interesting features of the local half-timbering has been attested to over many decades by impartial scientists as well as by irritated husbands. But once satellite navigation rendered the ability to tell the cartographic difference between a car park and a lake redundant, that aspect of male superiority disappeared out of the window, along with the crucial pages of the road atlas that the toddler removed while practising his superior hand-eye co-ordination skills.

Men, studies show, are exceedingly good at rotating three-dimensional shapes in their head. Perhaps women once stared open-mouthed in wonder as their mates juggled pyramids of imaginary polyhedra. Such tricks are also quite handy for engineers who specialise in building large bits of machinery, digging tunnels or slinging bridges across rivers. But, now that the rich world has about as many tunnels and bridges as it needs, and the large bits of machinery which aren't made by computers and robots are made by the Chinese, their usefulness is limited.

Modern professional life is dominated by management, which these days sets high store by emotional

intelligence, empathy and communication. Wise chaps seeking professional advancement should therefore spend their free time with groups of women, boning up on how to undermine somebody's confidence while pretending to boost it, and how to turn an entire lunch table against an absent colleague without saying a mean word. Such skills are likely to have a greater influence on their lifetime earnings than the ability to spin an icosahedron. It's a girlie man's world, as Arnold Schwarzenegger didn't say.

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On navigation systems, economic models, South Africa, Israel and Lebanon, Venezuela, Shamil Basayev, English

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Mapping the future

SIR – Charlemagne gave a misleading impression about the Global Positioning System (GPS) and Galileo navigation networks (July 15th). While the United States Department of Defence is the steward for the GPS, the service it provides (made free to people around the world) is overseen by a national committee that includes international participants in its advisory arm. This committee safeguards the service, 90% of whose users are non-military and which has become critical to the management of everything from tracking cargo to farming.

Furthermore, Charlemagne states that the GPS is accurate to five metres. This was true in the early 1990s, but the system has improved and today provides an average measured user range error of 1.1 metres. Finally, Charlemagne posits the GPS and Galileo as competitors. However, America and Europe recently completed a partnership agreement that synchronises the signal structure of the two systems. As a result, future GPS/Galileo receivers will be able to combine both the systems' signals to achieve better performance than either provided on its own.

Steven Huybrecht
Director, Space Programmes
Office of the Secretary of Defence
Washington, DC

Economic-building blocks

SIR – Your excellent report on economic models raises troubling questions for both the builders and the consumers of such models ("Big questions and big numbers", July 15th). The root of many problems lies not in the models themselves but in the way in which they are used. Too often we ask "What will happen?", trapping us into the mug's game of prediction, when the real question should be: "Given that we cannot predict, what is our best move today?" This subtle shift in emphasis from forecasting to informing resolves many of the conundrums you raised.

Instead of determining the "best" model that solves optimal strategies we should instead seek the most "robust" model that achieves a given level of "goodness" across myriad models and uses assumptions consistent with known facts. My colleagues and I use such methods to address intractable policy issues fraught with arguments over which model is "right", what assumptions are valid and what is the nature of the good? This method makes the decision to be informed part of the analysis itself and the results are more readily accepted by policymakers.

Steven Popper
Senior economist
RAND Corporation
Santa Monica, California

SIR – The notion among policymakers that tariffs are slapped on steel imports "to save jobs in Pittsburgh" is outdated. The city has struggled for 25 years to recover from industrial decline and its economy no longer resembles that of the mid-20th century.

Timothy Krizner
Guelph, Canada

South Africa's media

SIR – As you reported, the South African Broadcasting Corporation (SABC) is subservient to the wishes of the ruling African National Congress (ANC) and the very fact that Dali Mpofu, the SABC's boss, attacked an opposition party in your article is indicative of the state broadcaster's bias ("Watchdog or cheerleader?", July 15th). There are two views competing in South Africa over the role of the public broadcaster. One view values press freedom and argues that the SABC should broadcast in the public interest—a concept that embodies values of justice and equality. The ANC and its fellow travellers have a different view, arguing that the public broadcaster should embody the "national interest", which means the interests of particular groups trying to achieve a hegemonic domination of South Africa.

The former view is in keeping with South Africa's liberal democratic constitution; the latter exhibits a dangerous majoritarianism that pervades the ANC. The debate is more significant than most care to admit because it shows that the ANC espouses the value of constitutionalism only when it does not conflict with its own hegemonic agenda.

Tony Leon, MP
Leader of the Official Opposition
South African Parliament
Cape Town

Prisms of war

SIR – The title of your leader on the current crisis in the Middle East could not have been more misleading or dangerous ("The accidental war", July 22nd). Timing issues aside, this war is the result of calculated Israeli battle plans activated at an opportune moment. Israel wanted this war. Clearly it feels threatened by Hizbullah and endeavours to destroy the organisation's power. The Bush administration's repulsive rejection of an immediate ceasefire is a mistake and risks sabotaging its ability to broker a stable agreement in the aftermath.

Michelle Zimney
Santa Barbara, California

SIR – This crisis was neither accidental nor without warning. Iran, the main instigator of the war and supporter of Hizbullah, announced its intention to destroy Israel a couple of years ago.

Lawrence Shapiro
Sebastopol, California

Elections in Venezuela

SIR – You repeat the claim made by opposition parties in Venezuela that the National Electoral Council is biased against them ("Damned whatever they do", July 22nd). These claims are unfair. The council has invited the electoral authorities of Finland, Belgium and Switzerland to audit its system (together with six Venezuelan universities and the Venezuelan Institute of Scientific Research) and asked the three main opposition presidential candidates to designate representatives to participate in the audit. It has also agreed that immediately after next December's election, 53% of the ballot boxes will be opened randomly to check their contents against data from electronic voting. By the way, Alfredo Keller, whom you describe as merely a "pollster", is a well-known supporter of the opposition.

Alfredo Toro Hardy
Ambassador of the Bolivarian Republic of Venezuela
London

Prisoners of the Caucasus

SIR – Your obituary on Shamil Basayev, a Chechen warlord, arrived just as I finished reading Leo Tolstoy's account of the life of Hadji Murad (July 15th). Murad was a Chechen warlord in the 1850s who joined the Russians in the Caucasus and was eventually killed by a rival warlord. Tolstoy's story is wonderful and filled with rich and colourful descriptions of life in the region. Some 150 years later, one wonders if things are all that different and if anything has been learnt by either side.

Julia Smith
Wells, Maine

Like, er, awesome

SIR – The Human Genome Project is “sooo yesterday” (“A study with a lot of balls”, July 29th)? I mean, like, wow. My advanced language students use *The Economist* to appreciate excellent written English. Like, unreal. Perhaps we should switch to a different text? Like, *Hello!*?

David Legard
Singapore

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The Lebanese crisis

Trying in vain to find a way out

Aug 3rd 2006 | BEIRUT, JERUSALEM AND NEW YORK
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The United Nations is desperately looking for a peace plan but no one seems to know how it would work

NEARLY three weeks into Israel's campaign against the Islamist militias of Hizbullah in Lebanon, hopes for a diplomatic breakthrough leading to an early ceasefire were badly dented when Israel's air force dropped bombs on a building in the small town of Qana, 12km (eight miles) north of the border. Israel said militants who had just fired a Katyusha rocket had taken refuge in the building. But, as had been the case ten years ago when Israel had shelled a UN compound in Qana in reply—it said—to Hizbullah fire, dozens of civilians were sheltering there too. The death toll of at least 28, including 16 children, was not only the worst so far in this war; it knocked diplomatic efforts to find a solution askew.

A few days before, Hizbullah's two representatives in Lebanon's government had unexpectedly consented to a seven-point peace plan proposed by the prime minister, Fouad Siniora. It would have brought the official Lebanese army into south Lebanon, where Hizbullah has long held sway, and beefed up the UN's existing monitoring force, known as UNIFIL. Under the plan, Hizbullah would also free the two Israeli soldiers it kidnapped on July 12th, triggering Israel's attack, in return for three Lebanese prisoners (one an Israeli citizen) in Israel. The UN would also reconsider the status of the Shebaa Farms, a sliver of disputed land it had previously deemed to belong to Syria (and is occupied by Israel as part of the Golan Heights) but which Hizbullah and the Lebanese government claim as Lebanese.

The plan fell short of the full disarmament of Hizbullah that Israel demanded, and that the UN called for two years ago in its resolution 1559. But it was a big step forward. Israel had dropped hints, albeit later denied, that it could be flexible about Shebaa. Condoleezza Rice, the American secretary of state, was due to come to Lebanon from Israel to wrap up the details. But after the Qana slaughter, Mr Siniora told her not to bother until the UN had imposed an Israeli ceasefire.

That has meant a frenetic week at the UN in New York. The challenge is to come up with a package that will keep Hizbullah out of south Lebanon after Israel withdraws, and do it fast enough to stop the war before any more massacres occur. The UN was hoping to pass a ceasefire resolution, which America had refused to promote before the horror in Qana, this week. But a second resolution on a peacekeeping force will take longer.

All the big players agree on the need for such a force. The consensus is that it will not be an expanded UNIFIL, which Israel distrusts as ineffectual, nor something under the auspices of NATO, which many Arabs, especially Hizbullah, distrust as another American proxy. Estimates of its likely size vary wildly, from 8,000 to more than 20,000 troops. No country has yet promised any. America and Britain will provide backing but not men, as they are overstretched in Iraq.

Behind the scenes, France is emerging as the lead nation in the scheme (see article). Turkey, which has longstanding relations with Israel, may be a leading contributor too, putting a Muslim face on the peacekeeping force.

So a new UN force in Lebanon may risk looking like a Frankenstein's monster, with French leadership, a mandate from the UN, Muslim legitimacy from Turkey, logistical support from NATO, and money and diplomatic backing from the United States and Britain. In any event, a plan has yet to be agreed that would either disarm Hizbullah or fold its militia into Lebanon's official army. No country sounds keen to tell its troops to fire on Hizbullah if it disobeys. A UN official says that this question must be settled before an international force can be agreed upon.

It is not clear, in any case, that a ceasefire would happen just because the UN asks for one. Israel, which briefly stopped its air attacks a day after the Qana tragedy at Ms Rice's insistence, started bombing again within 12 hours and returned to a full-scale offensive two days later. Its politicians are still determined to strike a decisive—and visible—blow against Hizbullah before time runs out.

The war's initial euphoria in Israel—at last, a fight that nobody could accuse Israel itself of starting, launched from a territory that it was not occupying, by an enemy that unashamedly wants to destroy it—is turning into doubt and recrimination. On July 30th the generals were saying they needed about two more weeks to reach their goal of “significantly weakening” Hizbullah, the same timetable they had given two weeks before. Rockets still rain on northern Israel—231 of them on August 2nd, the biggest daily total ever. Last week, the first battles between Israeli troops and Hizbullah forces in the militants' border strongholds brought unexpectedly high Israeli casualties. Meanwhile, Hizbullah's public-relations engine, its al-Manar television station, still emits propaganda and speeches by the movement's charismatic leader, Hassan Nasrallah, despite having its headquarters bombed to rubble.

Inevitably, there are murmurs that Dan Halutz, Israel's first airman to hold the job of chief of staff, was too keen to show that Hizbullah could be dealt a crushing blow from the air alone, and that the army was too late in bringing in ground troops. But the preference for air power may well owe more to the politicians. Israel was wary of repeating its mistake of 1982, when what was meant to be a lightning offensive against Palestine Liberation Organisation (PLO) bases in south Lebanon turned into an 18-year-long quagmire for Israel's army.

In fact, argues Moshe Yaalon, a former chief of staff, Israel has made progress. The air strikes, he says, have taken out a lot of Hizbullah's longer-range rockets; good intelligence had pinpointed the houses and even the rooms that Hizbullah had set them up in. The small and portable Katyushas that remain do little damage and do not travel far; in the past few days the hits on the larger and more distant Israeli towns, like Haifa, have dropped, though there was another flurry on August 2nd.

The Katyushas, however, cannot be destroyed from the air; they are too easy to hide. This week, trying to outrun the UN, the government decided to step up the ground offensive. Thousands of infantry and tank troops have been sent to the front, where they are concentrating on destroying Hizbullah posts near the border and in nearby towns and villages. They may be joined by more reserve troops. The goal is first to create a Hizbullah-free zone six to eight kilometres deep, and ultimately to beat Hizbullah's forces back as far as the Litani river, some 30km north of the western half of the Israeli-Lebanese border. Emptying the entire area of civilians may, by some analyses, be part of Israel's strategy.

It will be a tough task. After years concentrating on “low-intensity conflict” against Palestinians, this is more like the big wars Israel fought decades ago—but harder, because Hizbullah enjoys some advantages of both conventional and guerrilla armies. Unlike most guerrilla forces, it has had six years to train, prepare, dig bunkers and stockpile supplies, with unfettered access to weapons from Syria and Iran across porous borders. Israeli soldiers coming back from the front have reported encountering tougher and better-trained fighters than they are used to.

Unlike a conventional army, Hizbullah has been able to hide its men and its weapons among civilians—making Israel much more reliant on intelligence in pinpointing targets, and forcing it to constrain attacks to try—in vain, as it often turns out—to limit civilian casualties. Moreover, Hizbullah operates in small, autonomous and largely self-sufficient cells.

Even with most of Hizbullah gone, a few remaining cells can do disproportionate damage—not physically, but in the public perception. So Israel needs physically to push Hizbullah and its Katyushas back most of the way up to the Litani, and through air strikes destroy most of its long-range rockets, which can hit Israel from deep inside Lebanon.

Which is why this week Israel's government has been playing up the successes. It claims to have taken out most of the long-range rockets already. A commando raid on August 1st at a hospital in Baalbek, deep inside Lebanon, which Israel says netted five Hizbullah prisoners, may not have caught a big fish for a prisoner swap but did show that Israel can strike anywhere it wants to; reports from Lebanon say 17 people, many of them civilians, were killed.

Indeed, while Lebanon's civilians continue to suffer grievously, with some 800 of them thought to have been killed, the physical damage to Israel has been light. Hizbullah rockets have so far killed 18 civilians, while 35-plus Israeli troops have died during the ground offensive.

But Israelis' sensitivity to attack, and their media's intense focus on each and every soldier killed, has strong political and psychological effects. Drowning out the grumblings about poor military planning are charges that Israel should never have left south Lebanon, which freed Hizbullah to build itself up in the first place.

Hitting back too hard?

More plausibly, some think this war could have been pre-empted. Giora Eiland, until recently Israel's national security adviser, recalls that when Syria pulled its forces out of Lebanon in 2005, fulfilling their part of UN Resolution 1559 and so removing one of Hizbullah's props, he advised seizing the moment with a deal similar to the one being discussed now. Israel would free its Lebanese prisoners and hand

Lebanon the Shebaa Farms, thus robbing Hizbullah of its two main reasons for attack, in return for Hizbullah's disarmament.

Many doubt this will work now. First, the death toll in Lebanon has turned world, and especially Arab, opinion so strongly against Israel that it is much harder now to force Hizbullah to disarm. Second, however far Israel has pushed Hizbullah back by the time the war ends is where it will probably stay; no multinational or Lebanese force is likely to do more than maintain the status quo. Third, Israel's army must stay in place until the other force arrives, making itself vulnerable to attacks (and more kidnaps) and earning ever more Arab enmity. Fourth, once Israel is gone, Hizbullah cells may well creep back into their old territory unless the monitoring forces are unusually vigilant—and willing to fight them. Fifth, these forces will have to patrol the border too, to keep weapons out, and even the best-kept borders are notoriously porous.

Finally, asks Efraim Halevy, a former head of Mossad, Israel's foreign intelligence agency, what if Hizbullah attacks the multinational force, as it did with car-bombs in 1983, killing 301 American and French troops? The gruesome cycle of repeated history would simply turn again.

Best of all, from Israel's point of view, would be to remove Hizbullah's external support. Udi Sagi, a former general who once headed negotiations with Syria, this week publicly argued that now is the time to restart negotiations with Syria over the Golan Heights, which Israel occupied in 1967. Given the limitations of the Lebanese army and any foreign force, peace with Syria, which is thought to supply some of Hizbullah's weapons and to provide a conduit from Iran, may be the only reliable way to stop Hizbullah rearming. But for now, peace talks are not on offer.

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France and Lebanon

Once again, a leading light

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The French are back in the fray

IN THE past fortnight Philippe Douste-Blazy, France's foreign minister, has been to Beirut three times. President Jacques Chirac has also sent Dominique de Villepin, his prime minister, there. His defence minister, Michèle Alliot-Marie, oversaw operations from a ship. Since the war began France has been keen to show its *solidarité* with the country it once ran. Translating these gestures into military help, however, may prove more tricky. In any event France is very much back in the Levant. It may well lead a multinational force to keep the peace.

France's closeness to Lebanon runs deep. Jacques Chirac chose Lebanon for his first presidential visit to the Middle East, in 1996. He was close to Rafik Hariri, the billionaire who was Lebanon's prime minister for a total of ten years and whose assassination last year started the mass protests that led to Syria's withdrawal. Mr Chirac keeps in close touch with his son, Saad.

Given this godfatherly relationship, France has not concealed its dismay at recent events. It has spoken out against Israel's "disproportionate" air strikes and what Mr Douste-Blazy called the "murderous raid" on Qana. It called from the start for an immediate ceasefire.

But France's ties to Lebanon also put it in an awkward spot. The assumption in Washington and London is that France could and should be the main contributor (with 5,000 or so soldiers) to a peacekeeping force On the one hand, it is quietly pleased to be courted. On the other, it has serious reservations about how to put such a force into place. This is not only because it already has some 11,000 troops in operations abroad, including 200 in the UN's hapless little force already in Lebanon. Mr Douste-Blazy said this week that "France is ready to take part", but on condition that any force is dispatched only after a UN ceasefire and a political deal between all parties. This collides with America's desire not to call for a ceasefire until a force is ready to move in and confront Hizbullah, paving the way for an accord.

The French also want the force to have a "Chapter Seven" mandate, which means it would be authorised by the UN to use force. Above all, they insist privately that they do not want to appear to be doing Israel's bidding by disarming Hizbullah: that job, they say, must fall to Lebanon's official army. As Mr Douste-Blazy admits, France is sensitive to the potential knock-on effects in its own disaffected Muslim-inhabited *banlieues*.

In some respects, France and America share many aims in Lebanon. They jointly sponsored UN Resolution 1559, which called for the restoration of full sovereignty in Lebanon, the withdrawal of foreign forces (meaning, in essence, Syria's), and the disarmament of militias. Even during their fall-out over Iraq, France and America managed to work together in this objective, and jointly squeezed Syria out of Lebanon.

Yet big strategic differences remain, particularly over Iran. The French may have held firm over Iran's nuclear programme, not flinching from going to the UN Security Council. But France has also been urging the Americans to give Iran the international recognition it craves. "Iran is an old civilisation, a great country," Mr Chirac told *Le Monde* last week: "We have to restore normal relations." Mr Douste-Blazy has since gone further: "It is evident that Iran plays a stabilising role in the region." To those in Washington urging military action, that is absurd. For France, it is a pivotal part of its peacemaking diplomacy by reining in Hizbullah without requiring it, as America and Israel would like, to be crushed.

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The Arab world

A surge of anger

Aug 3rd 2006 | BEIRUT
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The longer the war goes on, the stronger the Islamists and those who reject peace with Israel are becoming across the region

EPA

Cairenes cheering for Hizbullah

THE al-Jazeera satellite channel, prime viewing for millions of Arabs, labels this the Sixth War, after the Arab-Israeli conflicts of 1948, 1956, 1967, 1973, and the Israeli invasion of Lebanon in 1982. On the ground it still looks smaller than those earlier conflicts. It pits Israel, the perpetual protagonist, not against massed armour and multiple countries but against a single force which, though seasoned, spirited and armed with rockets, numbers only a few thousand men.

Yet this war has produced a potential for change that is at least as great as those other wars. This is not because the fighting has struck Israel's own cities or because its toll on Lebanon's civilians has been so shockingly high or because it has now, after three weeks, gone on longer than in any Arab-Israeli war since the first one.

Increasingly, this conflict has come to be seen by the combatants as one of survival. For Hizbullah, the aim is not just to bloody the nose of a more powerful adversary but to thwart the perceived evil intention of Israel's staunchest backer, the United States, to dominate the region.

This notion of a wider dimension has taken hold around the region. To many it is a proxy war between Hizbullah's main sponsor, Iran, and America. But it may also herald the re-emergence, after a decades-long trend among Israel's neighbours to accommodate the Jewish state, of a broad rejectionist front, this time inspired by pan-Islamist feeling rather than the pan-Arab nationalism of the 1960s and 1970s.

Anger has risen steadily across the region as the blood flows. This week, in the wake of the slaughter at Qana, it surged to new heights. But Israel, this time, is not the only target of fury. “May God inflict on the children of Jordan, Egypt and Saudi Arabia what He has inflicted on the children of Lebanon,” said a placard brandished by a protester in Beirut, pointing to America's closest Arab allies as complicit, by virtue of silence and inaction, in Israel's crime.

“People [across the region] see Hassan Nasrallah as the leader they've been waiting for for five decades,” says Marwan Kabalan, a Syrian academic, of Hizbullah's turbaned and telegenic chief. With American policy now “in tatters,” he—like many other observers—foresees American influence in the region being rolled right back. President Hosni Mubarak of Egypt, the first Arab country to make peace with Israel, who now faces daily demonstrations calling for Mr Nasrallah to “destroy Tel Aviv”, speaks of the imminent collapse of any vestige of a peace process.

In Iraq, too, pro-American politicians give warning that, as Lebanon's Shias suffer, their Iraqi brethren may well join Sunnis in a full-scale uprising. Even in stridently Sunni Saudi Arabia, conservative clerics who denounced Hizbullah as an Iranian tool have faced a furious backlash of calls for Muslim unity in *jihad*.

In Lebanon itself, the large, pro-Western liberal elite is palpably at a loss. Many have left the country, their hopes shattered after being raised by the drama of a year in which a movement with broad support across the many religious groups had united behind calls for peaceful change, and ended years of domination by neighbouring Syria. “We were the only people in the Arab world to truly and honestly believe in the American programme for democracy,” says Osama Safa, a Shia analyst who has been

critical of Hizbullah. “Now we've driven into a wall at 150 miles per hour.”

Before the war, Hizbullah had been increasingly isolated in its insistence on maintaining its bellicosity to Israel. With most Lebanese, including many Shias, just beginning to taste the fruits of reconstruction, and with a record summer tourist season in prospect, the Islamists were widely regarded as a dangerous anomaly. Though many respected its toughness and reputation for probity, Hizbullah seemed to promote an agenda that benefited Syria and Iran more than its fellow Lebanese.

Such doubts and fears have not gone, but criticising Hizbullah in public has become a taboo. Commentators concur that, in the short run at least, Israel's attempt to blame Mr Nasrallah for Lebanon's destruction has backfired. Instead, Israel's bombing of bridges, factories and traffic far from the front is seen as indiscriminate revenge. Israeli strikes against the Lebanese army, which represents all sects and has not joined the fighting, are felt as a national humiliation. The wave of northbound refugees—more than 800,000 people, mostly poor Shias, are thought to have been displaced—has prompted an outpouring of cross-sectarian sympathy and charity.

Lebanon's shaky coalition government, hamstrung by sectarianism, has been weakened by its physical impotence in the face of Israel's onslaught and by its failure to win diplomatic support for an immediate, unconditional ceasefire. Many think the prime minister, Fouad Siniora, brave and capable but doomed by too close an association with the West. Even if Hizbullah emerges militarily weaker, it may become more popular and more extreme, empowering those who now condemn Mr Siniora and his allies as traitors.

As for the wider region, whether Hizbullah emerges as victor or vanquished, it has proved an inspirational model for change. “When the dust settles, we'll be facing a new strategic equation, a paradigm shift,” says a gloomy senior Western diplomat. Non-state actors ideologically aligned to Hizbullah, such as the Muslim Brotherhood, may well get stronger. It is precisely because the stakes are so high that a ceasefire has proved so elusive.

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Economist.com SPECIAL

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Iran

The regional manipulator

Aug 3rd 2006 | TEHRAN
From The Economist print edition

It is unclear on what terms Iran would press Hizbullah to cease its fire

WHAT odds on the foreign minister of a prickly Middle Eastern state sitting down to a cordial chat with his opposite number from a Western country that had, only a few hours before, sponsored a UN Security Council resolution threatening sanctions against his country? On July 31st, the day the council said it would take “appropriate measures” if Iran did not suspend its controversial uranium-enrichment plan, Manuchehr Mottaki, Iran's foreign minister, and Philippe Douste-Blazy, his French counterpart, spent two hours in Iran's embassy in Beirut, discussing ways to end the Israeli-Lebanese conflict. Iran has not hidden its satisfaction that France and others in the EU regard it as a potential agent for peace, and not solely, as Israel and the Americans see it, as an instigator of aggression.

The welcome Mr Mottaki received in Beirut from his Lebanese counterpart, and the contrast it presented with Lebanon's cancellation of a planned visit by Condoleezza Rice, the American secretary of state, boosted Iran's self-esteem. Since the conflict started, Iran has basked in the widespread—but only partially true—perception that the Islamic Republic, as a founder (with Syria) of Hizbullah in the 1980s, and latterly as its suspected main arms supplier, can orchestrate events in the eastern Mediterranean. Yet behind Iran's bravado there is worry at the way the war is going.

AFP

The anti-Zionist president

This week's intensification of Israel's assault on Hizbullah is raising fears in Tehran that Israel may eventually succeed in its stated aim of mauling Hizbullah militarily. That would be bad news for the Iranians, who, they have repeatedly made clear, see Hizbullah as a proxy agent of retaliation should Israel or America blast its nuclear installations.

Iran's hardline president, Mahmoud Ahmadinejad, reacted to the UN resolution by vowing that Iran would not give up enrichment, though the Iranians say they will reply, on August 22nd, to a package of incentives offered by the UN Security Council's five permanent members plus Germany. That response may include a proposal, short of full suspension, designed to appeal to veto-holding waverers such as Russia and China, who have long been loth to impose sanctions.

In Tehran, officials adhere to the government line that Iran provides only humanitarian and moral support to Hizbullah. A conservative newspaper reported that Hizbullah had politely turned down requests from “private” Iranians that they be allowed to join the fighting. There is no sign that Iran has helped send over the suicide battalions that were formed earlier this year.

All this is in character. Since the beginning of George Bush's war on terror, Iran has perfected the art of manipulating regional conflicts while remaining officially above the fray. Iran's new challenge is to maintain Hizbullah as a deterrent to military action against the Islamic Republic. The trouble is that any multinational force would be deployed to ensure that the militia cannot strike Israel. The biggest question, then, is whether Iran would accept such a condition. At present, it seems unlikely.

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Middle East policy

To Israel with love

Aug 3rd 2006 | WASHINGTON, DC
From The Economist print edition

AP

Why America gives Israel its unconditional support

ANYBODY who doubts the size of the transatlantic divide over Israel should try discussing the Middle East conflagration in Britain and then doing the same in America. Everybody watches much the same grisly footage. But, by and large, people draw very different conclusions. The emphasis in Britain is overwhelmingly on the disproportionate scale of the response. Americans are much more inclined to give Israel the benefit of the doubt—and to blame Hizbullah. Some Jewish organisations are so confident of support for Israel that they even take out slots during news programmes, pleading for donations.

Opinion polls confirm that Americans are solidly on Israel's side. A *USA Today*/Gallup poll conducted on July 28th-30th showed that eight in ten Americans believed that Israel's action was justified—though a majority were worried about the scale of the action. A plurality (44%) thought that America was doing "about the right amount" to deal with the conflict. An earlier *USA Today* poll found that 53% put "a great deal" of the blame for the current crisis on Hizbullah, 39% put the blame on Iran and only 15% blamed Israel.

Similarly, Americans are far more likely than Europeans to side with Israel in the Israeli-Palestinian conflict. A Pew Global Attitudes survey taken between March and May found that 48% of Americans said that their sympathies lay with the Israelis; only 13% were sympathetic towards the Palestinians. By contrast, in Spain for example, 9% sympathised with the Israelis and 32% with the Palestinians.

The political establishment is even more firmly behind Israel than the public is. Support for Israel stretches from San Francisco liberals like Nancy Pelosi to southern-fried conservatives like Bill Frist. The House and Senate have both passed bipartisan resolutions condemning Hizbullah and affirming Congress's support for Israel. The House version passed by 410 to 8 (of which three were from districts in Michigan with concentrations of Arab-Americans). The Senate resolution, sponsored by 62 senators—including the leaders of both parties—passed unopposed.

Indeed, the parties are engaged in a competition to see who can be the most pro-Israeli. Twenty or so Democrats, including Ms Pelosi, the House leader, and Harry Reid, the Senate leader, demanded that Iraq's prime minister, Nuri al-Maliki, retract his criticisms of Israel or have his invitation to address

Congress cancelled. (Mr Maliki, strongly backed by the administration, was eventually allowed to go ahead.) Several leading Democrats, including Hillary Clinton, have addressed pro-Israeli rallies. The contrast with the simmering rage within the Labour Party over Tony Blair's support for George Bush could hardly be more marked.

Pro-Israeli forces command the intellectual high ground as well as the corridors of power. Commentators such as Charles Krauthammer issue column after column ridiculing the notion of proportionality and stressing Hizbullah's responsibility for civilian casualties. Most middle-of-the-road commentators question the effectiveness, rather than the morality, of Israel's actions. Out-and-out critics of Israel are relegated to the sidelines.

Why is America so much more pro-Israeli than Europe? The most obvious answer lies in the power of two very visible political forces: the Israeli lobby (AIPAC) and the religious right. AIPAC, which has an annual budget of almost $50m, a staff of 200, 100,000 grassroots members and a decades-long history of wielding influence, is arguably the most powerful lobby in Washington, mightier even than the National Rifle Association.

“Thank God we have AIPAC, the greatest supporter and friend we have in the whole world,” says Ehud Olmert, Israel's prime minister. The lobby, which is the centrepiece of a co-ordinated body that includes pressure groups, think-tanks and fund-raising operations, produces voting statistics on congressmen that are carefully scrutinised by political donors. It also organises regular trips to Israel for congressmen and their staffs. (The *Washington Post* reports that Roy Blunt, the House majority whip, has been on four.)

The Christian right is also solidly behind Israel. White evangelicals are significantly more pro-Israeli than Americans in general; more than half of them say they strongly sympathise with Israel. (A third of the Americans who claim sympathy with Israel say that this stems from their religious beliefs.) Two in five Americans believe that Israel was given to the Jewish people by God, and one in three say that the creation of the state of Israel was a step towards the Second Coming.

Religious-right activists are trying to convert this latent sympathy into political support. John Hagee, a Texas televangelist who believes that supporting Israel is a “biblical imperative”, recently founded Christians United for Israel. Last month he brought 3,500 people from across the country to Washington to cheer Israel's war against Hizbullah. Mr Hagee's brigades held numerous meetings on Capitol Hill; both Mr Bush and Mr Olmert sent messages to his rally.

These pressure groups are clearly influential. Evangelical Christians make up about a quarter of the American electorate and are the bedrock of Mr Bush's support. Congressmen take on AIPAC at their peril. But they deal with well-heeled lobbies every day. And the power of the religious right can hardly explain why Democrats are so keen on Israel. Two other factors need to be considered: the war on Islamic radicalism, and deep cultural affinities between America and Israel.

Seeing themselves in Israel

Americans instinctively see events in the Middle East through the prism of September 11th 2001. They look at Hizbullah and Hamas with their Islamist slogans and masked faces and see the people who attacked America—and they look at Israeli citizens and see themselves. In America the “war on terror” is a fact of life, constantly reiterated. The sense that America is linked with Israel in a war against Islamist extremism is reinforced by Iranian statements about wiping Israel off the surface of the earth, and by the political advance of the Islamists of Hamas in Palestine.

But the biggest reason why Americans are so pro-Israel may be cultural. Americans see Israel as a plucky democracy in a sea of autocracies—a democracy that has every right to use force to defend itself. Europeans, on the other hand, see Israel as a reminder of the atavistic forces—from nationalism to militarism—that it has spent the post-war years trying to grow beyond.

Americans are staunch nationalists, much readier to contemplate the use of force than Europeans. A German Marshall Fund survey in 2005 found 42% of Americans strongly agreeing that “under some conditions, war is necessary to obtain justice” compared with just 11% of Europeans. A Pew survey found that the same proportion of Americans and Israelis believe in the use of pre-emptive force: 66%. Continental European figures were far lower.

Yet all this unquestioning support does not mean that America will give Israel absolute *carte blanche* to

do whatever it wills. Condoleezza Rice, the secretary of state, was visibly shaken after the tragedy in Qana where at least 28 civilians, half of them children, were killed by Israeli bombs. There are growing worries both about Israel's conduct of the war and its wider impact on the Middle East. Many of these anxieties are expressed by the “realist faction”. Chuck Hagel, a Republican maverick, has given warning that America's relationship with Israel “cannot be at the expense of our Arab and Muslim relationships”. Richard Haass, a State Department official under George Bush senior who now heads the Council on Foreign Relations, has laughed publicly at the president's “birth of a new Middle East” optimism about the crisis. Some of the worries extend to conservatives. Tony Blankley, a former press secretary for Newt Gingrich and a fire-breathing columnist for the *Washington Times*, says that “We ignore world opinion at our peril.”

A few cracks are starting to appear. But they are still insignificant in the mighty edifice of support.

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Anti-Semitism

Mad Mel

Aug 3rd 2006 | WASHINGTON, DC
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Words more usually heard in the 1880s

ON FRIDAY July 28th, Mel Gibson was arrested in Malibu for drunk driving. “My life is fucked,” said the actor. He then threatened the sheriff's deputy, called another officer “Sugar Tits” and issued a string of anti-Semitic comments. In doing so, he may well have turned self-pity into prophecy.

Mr Gibson has been accused of anti-Semitism before. Some Jewish groups criticised his 2004 movie “The Passion of the Christ” for exaggerating the Jews' role in the crucifixion, and he has neglected to condemn his father's characterisation of the Holocaust as largely fictional. This time around, the response has been vigorous. ABC, for example, excused itself from a deal it had made with the actor to develop a mini-series about the Holocaust. Mr Gibson quickly tucked himself away in rehab, apologised to the Jewish community and cravenly requested “healing” from Jewish leaders.

Anti-Semitism may cost him more than any of his previous sins. It is now quite unacceptable, though at one time it was rampant. From 1880 to 1925 some 2m Jews from eastern Europe came to America, joining around 250,000 who were already there. They attracted the suspicion of America's white Protestant ruling class, which took pains to exclude them from its clubs, corporate offices and universities. Anti-Semitism also took hold among some evangelical Christians and blacks.

Casual anti-Semitism became *de rigueur*. Franklin Roosevelt, who was wildly popular among Jews, let David Ben-Gurion languish in a hotel room for ten weeks in 1941 before refusing him a meeting. Virulent Jew-hating, such as that espoused by Father Charles Coughlin, a Nazi-loving broadcaster, did not survive the second world war. The Red scare of the early 1950s had anti-Semitic overtones, but by then overt anti-Jewishness had fallen out of vogue.

James Baker, George Bush senior's secretary of state, is reported to have said, in private, “Fuck the Jews. They don't vote for us anyway.” Under the current administration, however, the interests of Jews and Republicans have coalesced. Many evangelical Christians, too, have come to feel that the practice of some religion is better than none. George Bush, whose praise of faith is not limited to Christianity, is typical of this new type of philo-Semitic evangelical.

Evangelical Zionism, however, is in some cases self-interested. After Mr Gibson's arrest, the Rev Jerry Falwell reiterated his anticipation of Armageddon, which must take place in Israel.

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Cuban-Americans

Let's ban a book on Cuba

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Propaganda and subversion in the school library

THE book looks as jolly and innocuous as any other children's travel guide, and its 32 pages offer no obvious horrors. “People in Cuba eat, work, and go to school like you do,” reads one. Cubans enjoy eating chicken with rice. Cuba's beaches “are good for swimming and boating.” The cover shows laughing children against a rich blue sky. Only a second look reveals that they are all wearing the neck-scarves of Fidel Castro's Young Pioneers.

And that is quite enough. In Miami, a city that this week celebrated the news of Mr Castro's frailty and temporary handover with fireworks and wild dancing, “Vamos a Cuba” (“A Visit to Cuba”) is poison to some. Not only does it paint too rosy a picture of Cuba—suggesting that chicken is a staple, rather than a luxury, and implying that Cuba's best beaches are for Cubans, rather than for dollar-bearing foreigners—but it also sows alarming seeds of tolerance in the minds of the young. Although it has sat on library shelves for several years, a cry has gone up to get rid of it.

Juan Amador Rodriguez, a parent, started the alarm when he discovered the book. At an incendiary meeting in June of the Miami-Dade school board, members voted 6-3 (with all the Cuban-Americans voting “yes”) to remove the book from school libraries in the county. The ban also affects 23 other books in the same series on different countries. The American Civil Liberties Union (ACLU) and a group representing local students are challenging the ban in court. They allege that the board has exceeded its authority and is infringing free speech.

The board may be aware of that. In banning the book, it went against its own internal staff recommendations, including the advice of its own lawyer. Although teachers may control reading material in the classroom, the Supreme Court has ruled that school boards do not exercise “absolute discretion” over school library books, except where the content may be considered vulgar or in bad taste.

Critics of the ban say it can be neatly linked to the upcoming election season, and a nasty fight that is brewing between two Republicans. One of the figures at the heart of the controversy is an aspiring Republican state legislator, Frank Bolaños, who is running against a fellow Cuban-American to represent Miami-Dade in Tallahassee. Mr Bolaños also sits on the school board. Three other board members who voted against the book are running for re-election to the board. “It was only when the politicians got involved that the books were removed,” says JoNel Newman, the ACLU's lawyer.

On July 24th, the judge ordered the board to put the books back by July 31st, and said they should stay on the shelves as long as the trial lasted. In an 89-page opinion he made no effort to hide which way he was leaning. The school board, he wrote, had “abused its discretion in a manner that violated the transcendent imperatives of the First Amendment.” And, of course, the board has also encouraged lots more children and their parents to get “A Visit to Cuba” out of the library.

Instead of banning it, the ACLU suggests adding more books about Cuba to library shelves to represent a broader range of views. But that may not satisfy the book's opponents. Mr Bolaños and others have already raised objections to another school library book on Cuba, “Cuban Kids”. More offensive still, this one (also with Young Pioneers on its cover) blames Cuba's economic woes, in part, on America's 46-year trade embargo. Perhaps not without mischief, Amazon.com is suggesting that customers might like to buy the two offending volumes together.

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Anti-dumping

Shrimp cocktail

Aug 3rd 2006 | WASHINGTON, DC
From The Economist print edition

A new way to fleece foreigners

ANTI-DUMPING tariffs are among the most pernicious weapons in the protectionists' arsenal. Countries can impose these tariffs on imports that are ostensibly “dumped” or sold below cost. For America's shrimpers, they have also become a way to extract legal pay-offs from foreign competitors.

In 2004, urged on by domestic producers, America slapped anti-dumping duties on shrimp from China, Thailand, India, Brazil, Ecuador and Vietnam. Much to the chagrin of the American producers, these tariffs were often not high enough to shut out the foreign competition. Exporters from Thailand, for instance, paid dumping duties of 5-10% and still saw their business burgeoning in America. Overall shrimp imports are now worth around $3 billion.

But foreign shrimpers' access to America's market is highly uncertain. Anti-dumping duties are not set in stone. Both exporters and domestic producers can ask for a review. Earlier this year, the Southern Shrimp Alliance (an umbrella group representing American shrimpers and processors) demanded a review of the duties paid by all exporters in the six countries accused of dumping, some 700-800 firms.

When anti-dumping duties are reviewed, the Commerce Department looks closely at the books of foreign exporters to work out how much “dumping” has occurred. Since it could not possibly examine the internal accounts of the hundreds of firms cited by the shrimpers, most people expected the department to take its traditional approach: look at the three biggest exporters in each country and apply a weighted average of their tariff rates to everybody else.

Unfortunately, the Commerce Department had recently taken a different approach. In cases involving brake rotors from China and lumber from Canada, it chose the three target companies by lottery. That prospect terrified the shrimp exporters. Many of the firms officially on the anti-dumping list are small and might not have replied to the department's request. They would have then received a punitive duty of, say, 50% or more. As a result, the average duty applied to all importers would have shot up.

To prevent this possibility, foreign shrimp companies were desperate to avoid a reappraisal of the dumping duties. And the Southern Shrimp Alliance duly obliged, for a fee. In exchange for a pay-off, reputed to be up to 2% of the value of the foreigners' sales, the American shrimpers promised to withdraw their request for a reappraisal. By July, over 100 foreign companies, accounting for the majority of imports, signed up. Although the Southern Shrimp Alliance refuses to divulge financial details, the pay-off is clearly worth many millions of dollars.

What is more, the deals allow America's shrimpers to get hold of another source of protectionist cash: the proceeds of the dumping duties themselves. Thanks to the Byrd Amendment, an American law declared illegal by the World Trade Organisation and subsequently repealed by Congress, firms which file anti-dumping complaints can also collect the proceeds. Since the repeal of the Byrd Amendment does not take effect until October 2007, the shrimpers have some $150m of duties to collect.

Under the Byrd Amendment, the money from duties is meant to go to individual shrimpers and processors. The settlement money will go to the Southern Shrimp Alliance—much of it to pay the industry's lawyers. As for the rest, it will go to replenish the war chest for future legal manoeuvring.

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The wilderness

Where bike meets boot

Aug 3rd 2006 | MONO COUNTY, CALIFORNIA
From The Economist print edition

A new way of sharing America's unspoiled land

SINCE the Wilderness Act was signed in 1964, almost 7m acres (2.8m hectares), in 65 separate areas, have been preserved free of all things motorised. They may be entered only on foot, paw or hoof. But some people's idea of bliss out of doors involves an off-road vehicle going noisily and fast. What about them?

An unusual compromise may be the pattern of the future. It proposes expanding one wilderness area, the Hoover Wilderness in Mono County's section of the Sierra Nevada mountains, and making a small addition to another wilderness, in exchange for letting snowmobiles use an area next door. The plan is included in legislation proposed in April by Howard “Buck” McKeon, the Republican who represents all this empty country, and was discussed at a hearing in the House committee on resources on July 27th.

Under this legislation, 39,680 acres would be added to the existing 48,601-acre Hoover Wilderness and 640 acres to the 112,277-acre Emigrant Wilderness. Nestled between the additions would be two patches, 11,000 acres in all, where snowmobilers can roar and belch smoke to their hearts' content.

Neither side is entirely happy with this. The six months of talks were cagey and difficult. The snowmobilers would like more room to roam, the backpackers more quiet. At the hearing, the snowmobile interests made a last-minute bid for more acreage (probably for “extreme” snowmobiling), which caught even Mr McKeon by surprise.

But both sides have tried to weigh things up realistically. The town of Bridgeport, the largest in the region, needs freespending snowmobilers for its economy. (By contrast, backpackers, who camp rather than lodge, tend to be a frugal lot.) And the area has already been colonised since the 1950s for other uses, such as a mountain-warfare centre that trained the first marines to enter Afghanistan.

Mono County's winter economy is centred at present on the Mammoth mountain resort, well south of Bridgeport and the proposed snowmobile areas. But Mammoth has joined nearly 250 other local businesses supporting the compromise. “We want to market this area”, says the county supervisor. “This is world-class snowmobile country.”

Plans are already being drawn up for a county-sponsored website that would display maps of the expanded reserves. And up on the mountain-ridge boundaries, electronic transmitters will monitor noise, vibration and motion to keep the snowmobilers and the hikers out of each other's way.

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Washington's governor

Recovering from a bitter victory

Aug 3rd 2006 | OLYMPIA, WASHINGTON
From The Economist print edition

A shaky start has not prevented Washington's governor acting tough

CHRISTINE GREGOIRE, Washington's Democratic governor, got off to a terrible start in 2004: a lawsuit to turf her out. She had assumed office after the closest race in state history, having lost the first count by 261 votes and a machine recount by 42. State Democrats forced a hand recount, and that put Mrs Gregoire in the lead by 129 votes. Her Republican opponent, Dino Rossi, then went to court to evict the new governor.

Her hold on office was not secure until June 2005, when a judge tossed out Mr Rossi's lawsuit, giving Mrs Gregoire a winning margin of 133 votes. Even then, a poll showed that some 49% of the state's voters were not certain she belonged in office. Queries lingered over ballot-counting in King County, the most populous part of the state and a Democratic stronghold.

AP

Hard-earned applause

Sitting in her spacious office in Washington state's neoclassical capitol building, Mrs Gregoire admits it wasn't the best way to get going. “It was a bit of a challenge giving an inaugural address when you're looking at some members of the legislature who as of that day refused to recognise me as governor,” she says. “But I decided that if I'm here for six months or four years, I'm going to do my job.”

The 59-year-old governor, who previously served as director of the state's ecology department and state attorney-general—co-ordinating, in 1998, a $206 billion settlement between state governments and tobacco companies over smoking costs—set her tone early. Towards the end of the 2005 legislative session, she pushed through a long-stalled 9.5-cents-per-gallon increase in the petrol tax to mend the state's roads. She then helped to defeat a seemingly unbeatable citizens' initiative to overturn the tax.

This past spring Mrs Gregoire forced doctors and lawyers to agree on reforms in the state's medical-malpractice laws. That feat was particularly astonishing because, last autumn, each side had spent millions backing ballot measures designed to undermine the other lot. She has also laboured to settle disputes over water allocation in the agricultural eastern half of the state, and to resolve fights over unemployment insurance. “She's tackling the toughest problems we've had, and nobody has successfully done that before,” says one political insider.

Mrs Gregoire has even waded into Seattle politics, pressuring the city's fractious city council and Greg Nickels—Seattle's big, blunt-talking Democratic mayor, who towers over the small, slim governor—to agree on a plan to replace the 53-year-old elevated motorway along the Seattle waterfront, which looks horrible and is vulnerable to earthquakes. Mr Nickels is holding out for a $3-4 billion tunnel that would take the road underground. Others would prefer a $2 billion replacement above ground. In what one Seattle newspaper columnist described as imposing “adult supervision” on city politicians, Mrs Gregoire has made it clear that if they want state money for a new motorway, they must decide what to build, and by this autumn. In talk-talk Seattle, these are harsh terms indeed.

Mrs Gregoire's self-proclaimed penchant for bipartisanship faltered this spring when the legislature passed its budget. Republicans are grousing, and rightly so, that alleged reserves of $1 billion will probably be gone by 2010 because of the new programmes passed by the Democrat-controlled legislature.

But the governor's main obstacle to re-election, if she chooses to run in 2008, will be the way she entered office in 2004. Some still see Mr Rossi as governor-in-exile. Should he run, he will have at his immediate disposal a highly motivated base still furious over what they see as a stolen election. Mrs Gregoire's lagging ratings reflect that bitterness. Last month, only 52% of those polled approved of her work.

But the trend is upwards (from a low of 34% in May 2005), and the numbers are likely to be better now after a strong legislative session and a tide of good press, even in the conservative eastern half of the state. Moreover, this time Mr Rossi would be facing not a relative unknown but a sitting governor with a strong record. And the record will be even stronger if Mrs Gregoire makes the progress she hopes on education reform, health-care costs and government accountability.

There is, of course, always the chance of a political misstep or revelations of malfeasance. The state's economy—now one of the country's strongest—could sputter, costing Mrs Gregoire popularity, even as she touts for trade with countries ranging from France to China. But if all continues as it is now, Mr Rossi may find in two years' time that those 133 votes by which he lost have added a zero or three.

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The Arkansas governor's race

Cycling, and recycling, for votes

Aug 3rd 2006 | LITTLE ROCK, ARKANSAS
From The Economist print edition

An independent's do-it-yourself race to the governor's mansion

IN A rustic seafood restaurant on a warm Saturday night, Rod Bryan mingles with 75 or so supporters. These fans—artists, musicians, waiters, small-business owners—are far from Arkansas's rather posh typical political crowd, often with a night or two in the Lincoln bedroom behind them. But Mr Bryan, aged 37, is the first independent candidate to run for governor since 1940.

He faces stiff competition. The current Republican governor, Mike Huckabee, is standing down after two full terms. The Republican hoping to succeed him is Asa Hutchinson, an ex-congressman and former deputy in the Bush administration's Department of Homeland Security. The Democrat is Mike Beebe, the state's attorney-general and an old crony of Bill Clinton's.

AP

Bryan sells the brand

Mr Bryan, who plays bass in Ho-Hum, a popular local band, ran a small record shop called Anthro-Pop until he closed it a few weeks ago to concentrate on politics. To provide for his stay-at-home wife and two children, he works at a bakery. “I'm the only candidate who isn't a career politician,” he says.

He also campaigns in an unusual way, sending out one-page initiatives covering topics that no other candidate discusses. His first was about bicycles. He argues, not unreasonably, that making it easier for people to ride bicycles, as he does, would improve the quality of life, make everyone healthier and lessen Arkansas's obesity rate—one of the highest in the country.

Mr Bryan is gaining support from disenfranchised Generation Xers and “Emo kids” (young people afflicted with melancholia), besides baby-boomers who are disillusioned with the spin and double-talk of politics. His next single-sheet initiative will be on recycling. And he suggests that politicians might give back half their salary to a state programme, as he plans to do if elected.

His approach is do-it-yourself. While the other gubernatorial candidates raise millions, Mr Bryan and his friends gather in a friend's front garden on a Friday night to spray-paint political signs on recycled cardboard and estate agents' signs, and to design campaign T-shirts from donated castoffs. Cereal packets are cut into calling-cards.

Mr Bryan looks for inspiration to Texas, where Kinky Friedman, a musician and mystery-writer, is also running for governor as an independent. Perhaps he is hoping for a hoe-down on the Texas-Arkansas state line, with Mr Friedman and Ho-Hum trying to persuade other indies to run next time. Indie bands and labels have often turned music on its head. Can the same happen to American politics?

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Cuba

Fading away

Aug 3rd 2006 | HAVANA
From The Economist print edition

Reuters

An ailing Fidel Castro (right) has temporarily handed power to his brother, Raúl (left). It is the beginning of the end of the Castro era

"I AM in perfectly good spirits," declared Fidel Castro after being rushed into surgery on July 31st following a bout of intestinal bleeding. Since his medical details are a state secret, the rest of the world can only guess whether his health is as perky. But the Cuban dictator, who turns 80 on August 13th, was feeling unwell enough to hand over power temporarily for the first time in his 47-year rule, to Raúl Castro, his brother and Cuba's long-serving defence minister. Cuban exiles in Miami, convinced that the end of the Castro era is at hand, rejoiced, perhaps prematurely. Mr Castro may bounce back. Even so, his unplanned holiday from power will probably be seen as the beginning of the end of his rule.

The transfer of power to Raúl offers little indication of what will come next. As the most senior vice-president in the government, he is his brother's constitutionally designated successor. But he is 75 years old, lacks Fidel's charisma and will be widely regarded as a transitional figure. The big question is whether the rule of the Cuban Communist Party will outlast the Castro dynasty, or whether some configuration of dissidents, either those linked to the United States government or those determinedly independent of it, will emerge from their current obscurity to find a way to end its rule.

Fidel is the dreamer, according to revolutionary mythology, whereas Raúl is the enforcer. In the 1960s the younger of the two Castros is said to have personally overseen the executions of scores of Cubans loyal to the hated former dictator, Fulgencio Batista. An old joke told in Havana has Fidel pleading with his brother to stop shooting his enemies. "Whatever you say, Comandante," Raúl replies. "Shall I hang them instead?"

The real Raúl may be a moderating influence on his brother. Those close to him say it was he who urged Fidel to legalise the dollar in the desperate months after the collapse of the Soviet Union, Cuba's main supporter, in the early 1990s. The 50,000-strong army has been a pioneer of Cuban capitalism, acquiring interests in agriculture, tourism and industry. Raúl himself supervises much of Cuban tourism, one of the country's best-run industries. Cuba-watchers speculate that he might move in the direction of Chinese-style communism, which allows plenty of scope for economic but not political freedom, and away from the more doctrinaire Cuban kind.

Yet Raúl cannot replace his brother, who has persuaded millions of Cubans that he is the country's saviour and that its many failings are the fault of Cuba's enemies, especially the United States, which has maintained an economic embargo since the early 1960s. Cubans refer insultingly to Raúl as "*la china*", finding him effeminate and believing that he inherited his Asian features from a different father. They are unlikely to forgive him for their sufferings as readily as they have Fidel.

Raúl himself may recognise this. "Only the Communist Party as an institution can be the heir" to Fidel, he has said. This suggests that Cuba is preparing for some form of collective leadership, probably by top army officers and a younger generation of Communists. In April the party's Central Committee recreated its Secretariat, which could manage the formation of a new government. Possible future presidents include the foreign minister, Felipe Pérez Roque (a Fidel protégé), and Ricardo Alarcón, the relatively media-wise leader of the National Assembly.

The alternative to continued Communist rule is revolution, but the prospects for this look distant. The United States hopes that Fidel's passing will undam popular frustration, sweeping communism away. A recent report by the Commission for Assistance to a Free Cuba, blessed by George Bush, asks Congress for $80m over the next two years to help that happen by supporting independent sources of power and breaking "the regime's information blockade". But American sponsorship would rouse the nationalism of many Cubans and might doom any political force seen to be accepting it.

Home-grown dissidents, such as Oswaldo Payá, who wants free elections and the preservation of Cuba's generous social services, have more credibility. But many protest movements have been infiltrated by the regime, fight among themselves and are almost unknown to ordinary Cubans, who have little access to anything but the state-controlled media.

Cuba's next leaders will assume control of an economy that has weathered the "special period" that followed the collapse of the Soviet Union. High nickel prices, buoyant revenues from tourism and cosy relations with oil-rich Venezuela have improved matters dramatically. But relative prosperity has paradoxically sharpened discontent, especially among people who depend on the state-controlled formal sector for their livelihoods. Housing is in chronically short supply, infrastructure is crumbling and the fiscal deficit is a crippling 4% of GDP.

As it has for the past half-century, Cuba requires a foreign benefactor to keep its economy afloat. After the Soviet Union's demise, China and especially Venezuela have stepped in to help. Venezuela's populist president, Hugo Chávez, buys services from Cuba, mainly by employing its renowned doctors, at prices pegged to the price of oil, which it exports to Cuba in return. The Castros' exit, when it happens, is likely to spark a bidding war for Cuba's allegiance between Venezuela and the United States. Unless things change drastically, Venezuela is likely to win.

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Colombia

A presidential encore

Aug 3rd 2006 | BOGOTÁ
From The Economist print edition

As Álvaro Uribe starts his second term as president, he may find it difficult to match the successes of his first

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AP

Stretched thin, but paying court to Uribe

LEFTIST guerrillas traditionally greet Colombia's new presidents with violence. So a series of recent attacks, the bloodiest of which was an ambush on July 31st of an army patrol, probably by the FARC, the country's main rebel group, came as no surprise. The only novelty is that, for the first time in modern history, the outgoing and incoming presidents are the same man, Álvaro Uribe, who will start a second four-year term on August 7th. In his first term Mr Uribe's strategy of "democratic security" sharply reduced the number of massacres, murders and kidnappings that had plagued the country, which is why he won 62% of the vote in the election on May 28th. Yet some, mostly rural, parts of Colombia remain unsafe, and critics say the government is insufficiently democratic in security matters. Mr Uribe will find his second term harder than his first.

He owes his military success in part to $600m a year of aid from the United States, which helped finance a one-third increase in the size of the armed forces and the police; it also pays for schemes to eradicate coca, from which cocaine is produced. Even so, the government's forces are too stretched, says Sergio Jaramillo, a security analyst. Many of the new recruits have simply replaced some of the 30,000 right-wing paramilitaries who laid down their arms in April in exchange for leniency for past crimes. To pacify the country, says Mr Jaramillo, the government will have to extend the rule of law and the benefits of economic growth, which has averaged around 5% a year recently, to areas that have been controlled by the FARC and the paramilitaries.

This will not be easy. The paramilitaries have largely stopped their killings since their demobilisation, but they continue to threaten investigators and others, to traffic in drugs and to profit from stolen property. In a letter to Mr Uribe on the eve of his inauguration, Human Rights Watch, an NGO, urged him to enforce a ruling of the Constitutional Court that would increase punishments for paramilitaries who fail to disclose their crimes and give prosecutors more time to investigate them. But the government may not dare, for fear of goading the paramilitaries to regroup. *El Tiempo*, the country's biggest-circulation daily, reports that it intends to apply the most lenient possible interpretation of the law.

Some people speculate that Mr Uribe, having weakened the FARC but failed to defeat it, may use his second term to open talks with the guerrillas. Opinion polls suggest that Colombians would favour a deal to swap jailed rebels for hostages held by the FARC. After four years of retreat the guerrillas would no doubt welcome a respite and a chance to publicise their revolutionary views, which negotiations would provide. The violence on July 31st may be the FARC's way of trying to improve its bargaining position ahead of talks. "The time is ripe," says Eduardo Barajas, a political scientist. But neither side looks close to making the concessions required for a broad peace deal.

Congress, which has a veto over Mr Uribe's economic agenda, will be a more pliant partner. He won his first term as an independent but fought his second having built a coalition of pro-Uribe parties, which now dominate the legislature. The alliance has drawn him into some unsavoury horse-trading, which he largely avoided in his first term. When Radical Change, an ally that thought it had been given too few

government jobs, threatened to defect to the opposition, Mr Uribe was obliged to woo it back by readmitting to the coalition congressmen who had been purged because of suspected links to paramilitary groups.

That crisis overcome, Mr Uribe ought to have a stable legislative base of support, at least for a while. He will need it to enact his economic agenda, which is designed to help business. It includes an austere budget, the ratification of Colombia's free-trade agreement with the United States, which neither country has yet completed, and a tax reform. Mr Uribe wants to simplify the tax code and cut the top income-tax rate from 38.5% to 32%. He would recover the lost revenue by closing loopholes and expanding value-added tax to staples, such as rice and chicken. The poorest would be compensated through a cumbersome rebate scheme, which would return about $100 a year to 5m households.

This may be a political mistake. The tax reform is a “peculiar hybrid of the dubious stimulus of Reaganomics and the questionable subsidies of a welfare state,” says Alejandro Gaviria, an economist, who suspects that corrupt officials will grab the rebate. The losers will be the middle class, hitherto Mr Uribe's most stalwart supporters. If they become disenchanted, Colombia may swing left in the 2010 elections.

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Canadian citizenship

I'm a lumberjack, and you're not

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Who is a real Canadian? The evacuation from Lebanon prompts a debate

IN A country composed almost entirely of immigrants or their descendants, defining what it means to be Canadian is often the subject of heated debate. Tempers have flared over whether Sikh Mounties (national police) may wear turbans, whether Jews in Quebec may build huts on their balconies to celebrate the festival of Sukkot and whether religious groups, including Catholics, Mennonites, Jews and Muslims, may arbitrate disputes involving family law in Ontario. (The answers are yes, yes and no.)

A new and ugly chapter in this argument began in July after Israel's war against Hizbullah in Lebanon forced an evacuation of foreigners. Were all the 13,000 holders of Canadian passports ferried to safety at taxpayers' expense real Canadians? Or were some, as Garth Turner, a member of Parliament from the government's backbenches, insisted on his website, "Canadians of convenience", who had returned to live in Lebanon after meeting Canada's three-year residence requirement for citizenship and who "should hardly expect taxpayers here to gladly fly [sic] them across the world"?

Mr Turner's outburst echoed across newspapers, television and the internet. "Does Canadian citizenship mean anything?" asked Jack Lawrence Granatstein, a prominent historian. Perhaps it is too easy to obtain it, suggested Jeffrey Simpson, a columnist. Stephen Harper, the prime minister, has tried to calm the furore by promising to review dual citizenship.

That Canada, which prides itself on its multicultural make-up, is having this debate may seem strange. About 1m Canadians are of aboriginal stock; the other 31m either came from somewhere else or are descendants of someone who did. One reason for the fuss lies in changing immigration patterns. Until the early 1960s immigration law explicitly preferred Europeans to "black and Asiatic races". With racist provisions now removed, most immigrants are from Asia and the Middle East. But ending legally sanctioned racism has not pulled up all its roots.

Not all the suspicions are racist, though. A growing number of immigrants choose to keep their former citizenship. Of the 5.5m Canadians born abroad, 560,000 declared in the most recent census that they hold passports from another country. This feeds the belief that some are using Canada as a safety-net. In the approach to the British handover of Hong Kong to China in 1997, many Hong Kong Chinese emigrated to Canada, were granted citizenship and then went back. Today some 200,000 people in Hong Kong hold Canadian citizenship. The discovery in June that 17 members of immigrant communities were plotting terrorist attacks had already sparked doubts about some newcomers' commitment to their adopted country.

Unless he handles his review carefully, Mr Harper risks alienating actual and potential immigrants. Those already in Canada are concentrated in big cities, where his Conservatives fared poorly in January's general election. Mr Harper wants their votes to turn his minority government into a majority one. Potential immigrants are being wooed to ease growing labour shortages, particularly in the west. That is one reason why Canada admits around 240,000 immigrants a year, most of whom eventually become citizens. Would the highly skilled come if it meant severing their connections to home?

Canada is far from the only country to grapple with the complexities of dual citizenship. Around 90 countries, including the United States, allow it. Unlike Canada, though, the United States requires its citizens to pay American taxes no matter where they live. If Canadians did the same, they might grumble less about the cost of rescuing their embattled brethren from Lebanon.

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Mexico's contested election

After maths

Aug 3rd 2006 | MEXICO CITY
From The Economist print edition

An impressively bad loser draws the crowds

AP

Lopéz Obrador rides high

STANDING before a midnight crowd of several thousand in the Zócalo, Mexico City's central plaza, is Andrés Manuel López Obrador. The city's former mayor, and the presidential candidate of the centre-left Party of the Democratic Revolution in last month's election, is in his element. On July 30th he marched to the square for the third protest in a month. Then he declared that he was staying. He would, he said, live in the Zócalo until the Trife, the Federal Electoral Tribunal, a seven-judge court that is the final arbiter in electoral matters, had ordered a recount of all the ballots cast.

He also invited his supporters to stick around. They have. Thousands are camping in the plaza, and more have blocked off the Reforma, one of the city's main arteries. Because the local government, and so the police, are of Mr López Obrador's party, they have succeeded in paralysing the centre of Mexico's capital. This is a sharp escalation of his campaign to secure the presidency he apparently failed to win.

The crowds are impressively organised. Enormous canopies cover the Zócalo; banks of portable lavatories line the square's edges; and organisers circulate offering free food, drink and bedding. There is a steady stream of musical entertainment, and Mr López Obrador need not even speak to draw cheers: he sometimes just walks up on stage and smiles, revelling in his new-found role as the underdog. (He led the polls for most of the two years leading up to the election.) Vendors sell shirts and mugs adorned with his grinning caricature and the slogan, “Smile, we won!”

His supporters claim that the election was marred by fraud and that the Federal Electoral Institute, an independent body that oversees elections, favoured Felipe Calderón and his centre-right National Action Party. Mr Calderón won with a margin of just 244,000 of the 42m votes cast.

No convincing evidence of fraud has surfaced, but a recount could easily change the result. The Trife must decide by September 6th whether to order a complete or partial recount or none at all. If it does not do so or declare a victor by then, Congress would have to appoint a provisional president and a new election would be held early in 2008.

Mr Calderón argues that there are no legal grounds for a recount. Mr López Obrador says he would respect the results of a recount but has no doubt that he is the winner of the election.

So far Mexico has taken his insurrection in its stride. The stockmarket has barely fallen and most Mexicans expect a peaceful resolution. But with Mr López Obrador now occupying the capital's centre, some are beginning to wonder.

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Vietnam

Good morning at last

Aug 3rd 2006 | HANOI
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An economic boom is accompanied by remarkable success in getting rid of poverty and raising life expectancy

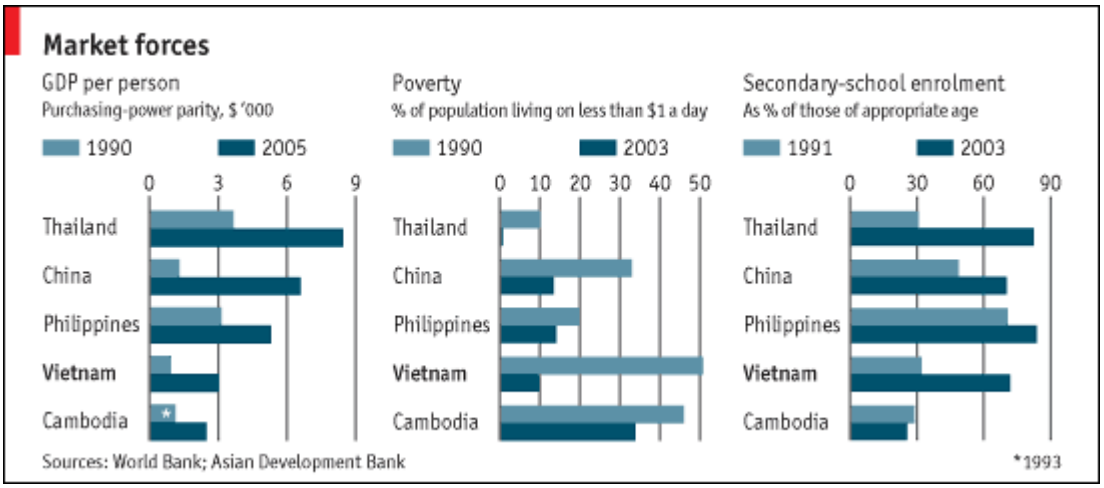
AFP

SIGNS of rapid development are visible everywhere around Hanoi: from the flashy sport-utility vehicles on the city's roads to the dormitory villages of smart “executive” homes rising among the fields on the capital's outskirts. George Bush and other world leaders will see it for themselves when Hanoi hosts the Asia-Pacific economic summit in November. That meeting will take place in a new satellite-city, Tu Liem, which is now being built on Hanoi's south-western edge. The futuristic conference centre, with a distinctive wavy glass roof, looks almost finished. Nearby, a huge five-star hotel is getting a final coat of paint. Along Tu Liem's broad, four-lane avenues, some apartment blocks are already occupied, others are just steel skeletons. Between the building sites, cows and buffalo still graze in what was open pasture only recently.

Before starting its *doi moi* market-oriented reforms in the mid-1980s, the Socialist Republic of Vietnam flirted with real communism and came close to famine. Since then, a reform process that was uneven at first has gathered momentum. Recent economic growth, though not quite as stellar as China's, has been remarkable. In 2001-05 it averaged over 7.5%, reaching a peak of 8.4% last year. This year the government is going all out to hit an 8% target.

Since 1990, Vietnam's exports have increased faster than China's. Their growth shows no signs of slackening. Between January and July they amounted to $22 billion, a year-on-year rise of over 25%. Having alarmed the Brazilians by becoming their main competitor in coffee growing, Vietnam is now ramping up its exports of everything from shrimps to ships to shoes (the last prompting the European Union to announce anti-dumping tariffs last month). It has just become the world's largest exporter of pepper and aims soon to overtake Thailand in rice. It is even selling tea to India.

Foreign-owned factories are chalking up the fastest gains. The government's aim of increasing electronics exports by 27% annually should be boosted by Intel's recent decision to build a $605m microchip plant in Ho Chi Minh City. Though farmers' harvests are still rising, industry's still-higher growth rate means that agriculture's share of economic output continues to shrink—from about 25% in 2000 to 21% last year. By 2010 it may be down to 15%.



This economic revolution is being accompanied by a social one. Though Vietnam is still, overall, one of Asia's poorest countries, with income per head behind India's, its recent growth has been impressively egalitarian. The Asian Development Bank (ADB) reckons that deep poverty in Vietnam—defined as a daily income equivalent to under $1—is now only slightly more prevalent than the average for South-East Asia, whereas in 1990 Vietnam's figure was more than twice the regional average (see charts). By this measure, Vietnam has overtaken China, India and the Philippines and now has only slightly more poverty than Indonesia.

Life expectancy has jumped and infant mortality plunged since the 1990s. Vietnam does better on both these counts than Thailand, a far richer country. Almost three-quarters of Vietnamese children of secondary-school age are in class, up from about a third in 1990. Again, Vietnam has overtaken China, India and Indonesia.

The new five-year plan, approved at April's congress of the ruling Communist Party, is laden with targets for increasing output and improving infrastructure, with the objective of making Vietnam a modern, industrial nation by 2020. Of course, other Asian countries' leaders, from Malaysia to the Philippines, declare similar objectives. The difference is that Vietnam's rulers seem to mean it—and their recent record suggests they might pull it off.

The April congress was preceded by a purge of high officials suspected of corruption—most notably at a road-building agency where some staff stole millions of dollars to bet on football matches. While Nong Duc Manh, the party's general secretary, has survived, the other two members of the ruling triumvirate—the president and prime minister—have since been dropped in favour of youngish, southern Vietnamese officials, seen as supporters of continued economic reform.

Good times, bad times

Vietnam is on a roll and its prospects look good. But much could still go wrong. As Vietnam joins the global economy (it should become a member of the World Trade Organisation in the coming year or so) it is becoming more vulnerable to volatile commodity prices and fickle bond-market investors, whose gyrations are largely outside its control. The recent export surge has been helped by strong global demand and high prices for the things Vietnam sells, from rice to crude oil, but a world recession—or an economic bust in China—could cause a big slowdown. The government is racing to build enough power stations, roads and railways to keep the economy moving. Any delays in these would spell trouble.

The communist government's continuing acceptance by ordinary Vietnamese rests largely on its success in delivering prosperity and better public services. If it fails to reduce corruption or produce jobs for the more than 1m young Vietnamese who join the labour force each year and the 1m villagers migrating to the cities, the country's social cohesion and sense of purpose would be in danger.

That makes it vital to accelerate the government's programme to restructure and sell thousands of state-owned firms. They are more graft-prone than private companies, and devour the lion's share of scarce land and credit while creating few new jobs. The private sector provides most of the growth in jobs and exports, but would do better still if it was not crowded out by the public sector. Le Dang Doanh, an economic adviser to the government, reckons that, but for the vested interests slowing down

privatisation, Vietnam could now be growing at 11%, just like China.

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Australia

Once more unto the breach

Aug 3rd 2006 | SYDNEY
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John Howard takes aim at a fifth term

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EPA

Me, again

AFTER weeks of tensions in Australia's ruling Liberal Party, John Howard, the prime minister, declared on July 31st that he would stay on to contest a fifth election as party leader in the general election due late next year. Since Mr Howard has led the party to four successive victories in ten years, most Liberal members of Parliament applauded his decision. The applause died a little two days later, however, when Australia's central bank announced a 0.25% rise in interest rates, to 6%. Ian Macfarlane, the bank's governor, said it was needed to dampen rising inflation and increased borrowing.

It was the third such rise since the last election, in 2004. Mr Howard won that poll by appealing to voters to trust his conservative government to "keep interest rates low". It was a rash promise: the central bank operates independently of government. Its latest rate rise has unnerved heavily indebted Australians. It has also sent jitters through the Liberal Party.

The subject of Mr Howard's retirement plans has dogged him ever since he once suggested he would consider his future when he turned 64. Last month he turned 67. Peter Costello, the treasurer (finance minister), deputy Liberal leader and heir-apparent, confirmed a press report in July that Mr Howard had given him a private undertaking in 1994 that he would hand over the leadership to Mr Costello after one-and-a-half terms of a Liberal government. Mr Howard denied it.

Having already become Australia's second-longest-serving prime minister, Mr Howard always had an option to retire well before the 2007 election with his impressive record of economic management intact. The bitter public row with Mr Costello over the succession killed that option, since he would have appeared to be standing down under pressure. As it turned out, Mr Howard telephoned Mr Costello on July 30th to say he would fight the next election as leader, then faxed his decision to his parliamentary colleagues. A downcast Mr Costello said he accepted that most Liberals did not want a leadership change now, and pledged to stay on as treasurer.

This means the budget Mr Costello is due to deliver before the 2007 election will be his 12th (seven years ago, he said he had only "another budget or two in me"). Mr Howard and Mr Costello have formed perhaps Australia's most formidable political partnership ever, delivering strong economic growth, a series of budget surpluses and falling unemployment during their decade in power. But little personal warmth exists between them. Mr Howard has no time for Mr Costello's liberal social agenda. And, as he turns 49 on August 14th, Mr Costello must contemplate that Mr Howard has now in effect wrecked his leadership ambitions. Even if Mr Howard wins the 2007 election and then retires, a clutch of equally ambitious Liberals is already elbowing forward to compete with Mr Costello for the crown. First, though, the Liberals have to win again. Rising interest rates won't make that any easier.

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China

Something new

Aug 3rd 2006 | BEIJING
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Getting serious about innovation

AFTER years of prospering as the world's workshop, China now wants to be its laboratory as well. “Innovation” has become a national buzzword, and Chinese leaders have been tossing it into their speeches since the beginning of the year, when President Hu Jintao started an ambitious campaign to drive China's economy further up the value chain. True, new campaigns and catchphrases are declared by the government and the Communist Party in China all the time, and mostly end up fizzling out in puddles of rhetoric. But there are signs that the government intends to back its innovation campaign with more than just words.

In launching their “National Medium- and Long-Term Programme for Scientific and Technological Development (2006-20)”, Mr Hu, the prime minister, Wen Jiabao, and other top officials have vowed to spend more on science and technology, and to insist on business reforms. Their goal is to move China beyond its dependence on natural resources and cheap labour, and stake its place among the economies that depend on education and information technology.

Officials say privately that the new policy emerged only after years of contentious internal debate. One divide was between nationalists, who advocated a go-it-alone approach towards developing indigenous technology, and others who were more open to international collaboration. There were also disagreements as to whether the campaign should concentrate on scientific mega-projects or incremental innovation.

One target is to reduce China's dependence on imported technology to 30% or less by 2020. According to Professor Fang Xin, of the Chinese Academy of Sciences, the initiative is a matter of necessity. China must learn to innovate if it is to sustain growth. Foreign firms, she notes, reap more than 60% of the profits from China's high-tech exports. Other officials say that, on average, China's 20,000 large and medium-sized enterprises undertake fewer than five new development projects and generate only two and a half new products each year.

The plan also calls for an increase in research and development spending from its current 1.23% of GDP to 2.5% by 2020, putting China in the same range as OECD countries' current scores. Ms Fang says banks and government departments will be told to help out with their credit, taxation and currency-exchange policies. According to Denis Simon of the State University of New York's Levin Institute, who advises the Chinese government on science policy, this move comes just in time. “If China doesn't do this right,” he says, “it risks becoming a good 20th-century industrial economy just when it needs to figure out how to be a 21st-century knowledge-based economy.”

But to succeed, says Mr Simon, China needs to attend to other matters as well. These include an “internal brain drain” that sees much of the country's best talent going to work for foreign firms in China, and the country's notoriously lax regime for protection of intellectual-property rights. Mr Simon predicts that such protection will improve as more local businesses with an interest in the matter join the chorus of complaints from foreigners.

Another huge obstacle is the nature of China's educational system, which stresses conformity and does little to foster independent thinking. Confucian philosophy reveres the teacher above all. More innovative Western economies, according to Ms Fang, operate under Aristotle's maxim: “I love my teacher Plato greatly, but I love truth more.”

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Kazakhstan

The revolt in Almaty

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However humble it may be, a Kazakh's home is his castle

THEY threw petrol bombs, burnt cars, and hurled stones at the police, in a desperate attempt to protect their homes. In turn, the police, who moved in to destroy the illegal settlement in the early morning hours of July 14th, fired rubber bullets at the protesters. In the heat of the riots, which left 30-40 people injured on each side, three policemen were taken hostage and one of them was doused with petrol and set on fire. He died of his burns last week.

Such outbreaks of violence are virtually unheard of in autocratic Kazakhstan. The confrontation at the Shanyrak settlement on the outskirts of the country's biggest city, Almaty, involved entire families and shocked both officials and the public. It showed that there is an unexpected potential for social unrest in this oil-rich country with its booming economy. People in Kazakhstan are usually indifferent to politics, and tend to ignore calls from the opposition to rally in support of democracy. But it seems that they will put up a fierce fight in defence of their homes. And there may be more to come.

Shanyrak is only one of up to 14 illegal settlements to have sprung up in and around Almaty over the past 15 years, with an estimated total of 70,000-100,000 inhabitants. Similar settlements surround other large cities, notably the capital, Astana. Although Kazakhstan is a multi-ethnic country of 15m, where Kazakhs became the majority only in the late 1990s, all of these settlers are Kazakhs. People from Russian or German ethnic backgrounds could return to their homelands during the economic depression of the early post-Soviet years. The only way out for Kazakhs from the impoverished countryside was to move to the cities in search of opportunities.

Having little or no money, they settled on open land within or just outside the city limits. Some acquired documents by bribing local officials; others were too poor even for that. Yet for many years, they lived undisturbed. This relaxed approach was pioneered by the previous mayor of Almaty, a Russian, who may have been loth to see his image tarred by evicting Kazakhs. The current mayor, Imangali Tasmagambetov, a Kazakh, has had no such qualms. With Almaty now experiencing a construction boom, clearing away the settlements has become a priority.

For the present, at least, the wholesale demolition is on hold. The people of Shanyrak are seeking to legalise their properties, though the outcome of these efforts is uncertain. Yevgenii Zhovtis, a human-rights activist, says he hopes that the authorities have learnt a lesson. But, he adds, “I am concerned that they will ultimately decide by force, in which case we will see more clashes.”

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Sri Lanka

Broken pieces

Aug 3rd 2006 | COLOMBO
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The peace process is in a terminal condition

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LIKE bystanders at a car crash, Sri Lanka's friends seem powerless to stop its screech towards renewed and full-blooded civil war. This week, for the first time since December 2001, government soldiers were engaged in a murderous land battle with the Liberation Tigers of Tamil Eelam. This intensified what was already, in effect, a seven-month-old undeclared war that mocks a ceasefire signed in 2002 and still, technically, in force.

The Sri Lankan army was fighting to open a sluice-gate in an irrigation system near Trincomalee, a north-eastern port. The Tigers, who for 23 years have been fighting for a separate homeland in the north and east for the Tamil minority, had blocked it, keeping water from a government-controlled area that is home to some 1,500 families and their crops. The Tigers said they were responding to the demands of residents in an area they control, angered by the government's failure to provide them with a promised water supply.

The government accused the Tigers of ethnic cleansing: an attempt to force the affected families, mostly Muslims or members of the Sinhalese majority, to move. This would help the Tigers grab more territory if, as seems likely, full-scale war resumes. Besides undertaking the concerted land offensive, the government bombed Tiger positions for more than a week.

The government justified its actions as a humanitarian effort to help water-starved families. In response, the Tigers this week tried to sink a ship carrying 854 unarmed Sri Lankan soldiers, and attacked Trincomalee harbour and four army camps. They also wrote to the Nordic group that is monitoring the ceasefire, asking for it to be declared void. Since April more than 900 people, over half of them civilians, have died in assassinations, suicide-bombings, mine attacks, government airstrikes or naval clashes. Tens of thousands have been displaced from their homes. More than 4,000 have fled by sea to the nearby Indian state of Tamil Nadu.

Neither side, however, has formally called the ceasefire off. The monitors are one of the last threads by which it is hanging. That one, too, seems about to snap. In June the European Union followed India, America, Canada and Britain in banning the Tigers as a terrorist group. Incensed, the Tigers say all EU

monitors must leave by September 1st. Of the 57 Nordic monitors, 37 are from EU countries—Denmark, Finland and Sweden. These countries say that, since the Tigers will not guarantee their monitors' safety, they must comply. Reduced to its Norwegian and Icelandic members, the mission may not be viable.

AP

Here we go again

That would leave foreigners looking powerless to prevent the slide to war. Sri Lanka grumbles at the inability of Norway, which arranged the 2002 ceasefire, to bring the Tigers back to the negotiating table. It would like India, the regional superpower, to play a bigger role. This is hard because of the disastrous nature of India's previous involvement. In 1987 it sent peacekeepers to disarm the Tigers, under an agreement that would have given the Tamils limited autonomy. But the peacekeepers were soon fighting the Tigers, and in 1990 the government asked them to leave. In 1991 a Tiger suicide-bomber killed Rajiv Gandhi, who had been India's prime minister in 1987, and whose widow, Sonia, now leads the ruling Congress party.

Sri Lanka's government has traditionally been suspicious of India, believing that the Tigers enjoy considerable support among the 60m or more Tamils of Tamil Nadu. Yet India has always ruled out the idea of an independent Tamil state in Sri Lanka, in part for fear of the example it might set separatist movements in India. Nevertheless, the Tigers attempted a conciliatory gesture towards India in June, calling the assassination of Rajiv Gandhi “a monumental historical tragedy”.

Last month India's top diplomat, Shyam Saran, visited Sri Lanka, met Mahinda Rajapakse, the president, and offered his country's help. Some see India's federal system as a solution to Sri Lanka's woes. In the past, however, the Indian model has always seemed, to the Sinhalese, to offer too much devolution and, to the Tigers, too little. The government's present formulation for peace is of “maximum devolution within a unitary constitution and an undivided country”.

The Tigers, however, do not seem in the mood to discuss this. They continue to accuse the army of providing support to a breakaway faction in the east, led by a colonel known as Karuna, with which they are engaged in bitter tit-for-tat killings. Mr Rajapakse is sensitive to international opinion and has insisted that, for him, a return to full-scale war is not an option. But diplomats say some members of his security services are less patient.

As for the Tigers, optimists say that not all their leaders favour a return to full-scale war. But they are brutally intolerant of dissent and ruthlessly efficient at enforcing a unified policy. Isolation may not make them more likely to join talks. Wounded tigers are dangerous.

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Hong Kong's culture of defenestration

Hard rain

Aug 3rd 2006 | HONG KONG
From The Economist print edition

When hope goes out of the window in Hong Kong, the furniture often follows

Get article background

“NEW YORK rain” is the local term for water that drips, annoyingly, from air-conditioners onto passers-by. In Hong Kong unwary pedestrians face more dangerous precipitation. On July 22nd a 78-year-old woman was rushed to hospital after a pair of scissors, hurled from a multi-storey building, lodged in her skull. The same day, a 28-year-old man in another part of the city suffered cuts after another pair of scissors hit him on the head, while a boy survived a brush with an iron bar lobbed from yet another high-rise window.

Despite all the modern sanitation at their disposal, many Hong Kong citizens still seem to prefer chucking rubbish out of the nearest window. As any housing estate resident will confirm, as well as a regular rain of beer cans and cigarette butts, other objects—used packets of Viagra, dirty cat litter, glass bottles, mattresses and even refrigerators—also fly past the window. Much of this is plain bad manners. But some also blame rising inequality for the downpour, which appears to be getting worse. Much of the object-throwing takes place in the city's public housing estates, where many of Hong Kong's poorer people live cramped together in tiny apartments. Many of their shoddily constructed buildings are crumbling: among the most common objects falling out of windows last summer were the windows themselves. As a result, the government had to spend HK$68m ($9m) on emergency maintenance of its housing.

Though the economy's recovery since the panic over the respiratory disease SARS in 2003 has lifted living standards, the fortunes of workers have lagged behind those of the middle classes. If people cannot heave their political masters out of office, they can at least heave a broken television out of the window. Given the mainland's far greater economic and social disparities, the authorities in Beijing must be hoping that this is one trend that does not spread north.

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Congo

After the poll

Aug 3rd 2006 | KINSHASA
From The Economist print edition

AFP

The first general election for decades went better than expected, but has confirmed a big division between east and west

IN THE end, after all the tension of the preceding week, Congo's general election on July 30th seemed to go rather well. Millions of Congolese voted patiently across their vast country, proud to be taking part in a historic moment—their first democratic vote in 46 years.

There were glitches. A few polling stations opened later than they should have, and the disappearance of information from the voters' register meant that some voters turned up to cast their ballots only to find their names were not on the lists or that someone else had voted in their place. As predicted, there was trouble in the Kasai provinces, strongholds of the opposition Union for Democracy and Social Progress, which had boycotted the election. Turnout there was low, a voting centre was attacked and the ballots from another destroyed. But there was no widespread unrest, as some had feared.

Furthermore, despite their threats, most of the thousands of rebels who still roam the east three years after Congo's war ended let the polling take place. And the capital, Kinshasa, where several policemen were lynched in riots in the week before the election, remained fairly calm. The biggest problem facing voters there was finding the name of their preferred parliamentary candidate among a list of over 800 and then cramming the eight-page ballot paper into the box.

The former president of Mozambique, Joaquim Chissano, who observed the election on behalf of a committee of African elder statesmen set up to settle any disputes about the voting, called it “an example for African elections”. The Carter Centre, an institute set up by ex-President Jimmy Carter that monitors elections, was critical of the government's intimidatory tactics during the campaign, but reckoned that the election itself was carried out in a “generally peaceful and orderly manner”.

But though outsiders had much praise for the election, those with more riding on the outcome have been less complimentary. The first few days since the poll have been full of complaints about fraud and over-hasty proclamations of victory.

Azarias Ruberwa, a vice-president and the leader of the Rally for Congolese Democracy, a former Rwandan-backed rebel group that is now a somewhat marginal political party, was quick to announce that fraud had been systematic, without producing any evidence. He demanded reruns of the election in some areas, and said he would contest the results in the supreme court. Hours after the polls closed but well before the count was complete, Jean-Pierre Bemba, a former Ugandan-backed rebel leader who poses the biggest challenge to the incumbent president, Joseph Kabila, said the first results gave him a clear lead. He also announced that he would not accept a Kabila victory if he found evidence of vote-rigging.

The election authorities and diplomats appealed for calm and told Congo's politicians not to predict the results. But one of Mr Kabila's ministers promptly responded on television by saying the 35-year-old president had won 90% of the vote.

Hold your breath

The electoral commission has said that provisional results for the presidential election could take as long as three weeks to come in: Congo is two-thirds the size of western Europe. Counting the votes could be chaotic. But the United Nations' radio station in Congo, which has over 100 journalists collecting information from counting centres and is perhaps the most accurate source in a country of rumours, has provided indications of what may emerge.

Partial results from the big towns appear to confirm predictions that Mr Kabila would do well in the east, whereas Mr Bemba has carried the capital and other parts of the west. Mr Kabila has tried to take the credit for ending Congo's 1998-2003 war, which, through illness, starvation or direct slaughter, killed about 4m people, and this tactic seems to have worked. He seems to be leading in the east with as much as 90% of the vote in some areas. Mr Bemba is from the north-western province of Equateur and has played on Mr Kabila's inability to speak Lingala (the language of the west) as well as the popular belief in Kinshasa that the president has strong ties to Congo's eastern enemy, Rwanda. The worry is that, if these early and unofficial results are confirmed, the election will have revealed a sharp east-west divide. It could leave a president with a strong mandate in the east but little or no support in the capital and the west.

If neither Mr Kabila nor Mr Bemba wins over 50% of the vote, a run-off will take place on October 29th. A second round of voting will anyway be held for provincial posts and the Senate. It seems unlikely that either Mr Ruberwa or Mr Bemba would return to the armed struggle in the bush if he lost. But, on current information, whoever wins is certain to have to bind together a divided country that is desperately in need of unity.

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Sudan

An island unto itself

Aug 3rd 2006 | KHARTOUM
From The Economist print edition

The capital benefits most from an economic boom

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THE conversations tend to be very different, but very predictable, when Khartoum's bourgeoisie gathers for espressos and croissants at the trendy new Ozone café. Americans and Europeans, mostly aid-workers, swap horror stories about the latest depredations in Darfur, Sudan's war-ravaged western region, or bemoan southern Sudan's "lack of capacity". At the Sudanese tables, however, Arab men, and often women, josh about their city's brand-new traffic lights, which most still ignore, share information about new government privatisations and greet old friends who have returned to live in the Sudanese capital after years abroad.

Khartoum moves up in the world

Both views of Sudan, Africa's largest country, are valid. It is just that the Western focus on Darfur, where about 2m people are living in refugee camps as the result of a still unresolved war in the region, has obscured another fact about Sudan: the country is booming. With low inflation, GDP growth of 8% in 2005 and 13% projected by the IMF this year, Sudan is one of the fastest-growing economies in Africa. Furthermore, this success has been achieved despite the fact that the country has been subject to American sanctions since 1986, the year that the IMF ended financial assistance to the country.

Oil undoubtedly plays a big part in this boom, accounting for about 80% of the country's exports, but it does not explain all the gains. Indeed, the IMF has given guarded praise to the policies initiated by Sudan's government to liberalise the economy. It is not the kind of attention that the Islamist regime in Khartoum, accused of genocide by America for its actions in Darfur, is accustomed to.

Oil, structural adjustments that began in 1998 and the relative political stability that followed the signing of a peace deal with rebels in the south last year are encouraging foreign investment, particularly from China and the Gulf states. More needs to be done to tackle corruption and eliminate stifling regulations, yet new economic opportunities are enticing thousands of the country's rich and educated diaspora to return. More and more, Sudan's ruling National Congress Party is toning down its hitherto robust Islamist language; the new emphasis is on economic development.

However, it is almost exclusively the Arab heart of the country that is benefiting from the boom. Nearly $3 billion of foreign direct investment has come to Sudan, but well over half of it has gone to the capital and its hinterland. In the past year hotels, telecoms companies, light industries and even a Thai massage parlour have opened in a city that is still nominally ruled by *sharia* law.

The development that most epitomises Khartoum's new dynamism is Alsunut. Meaning “point of meeting” in Arabic, this behemoth of a residential and office project is now under construction on 65 hectares (160 acres) of land where the Blue and White Niles converge. The $4 billion project, the result of a public-private partnership between the government and DAL Group, Sudan's leading company, will transform the city by adding 63 towers varying between 15 and 35 floors in height. Over half the office space has already been sold to local and foreign companies.

However, for all the new prosperity in Khartoum, evidence of the boom outside the capital is hard to find. Progress towards improving the lot of the majority of poor Sudanese is plodding. For most people, electricity is still rare and most schools still hold classes under trees.

And, crucially, Sudan's improved economic outlook has not had any discernible impact on the mainly Christian and animist south. Hundreds of thousands of displaced southern Sudanese are leaving their refugee camps in the north and returning to what remains one of the poorest areas in Africa. Indeed, the pace of recovery in the south is so slow that some aid agencies report that villagers have started throwing sticks and stones at their passing convoys as a form of protest.

The inequitable distribution of the country's wealth has always been a large factor in stoking rebellions in the south, in Darfur and in the east against the central government in Khartoum. If that remains true of this current boom—which may last only as long as the high price of oil—it will be a huge missed opportunity to reduce some of the inequalities that still threaten to pull the country apart, with disastrous consequences for all Sudanese.

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South Africa

Fear factor

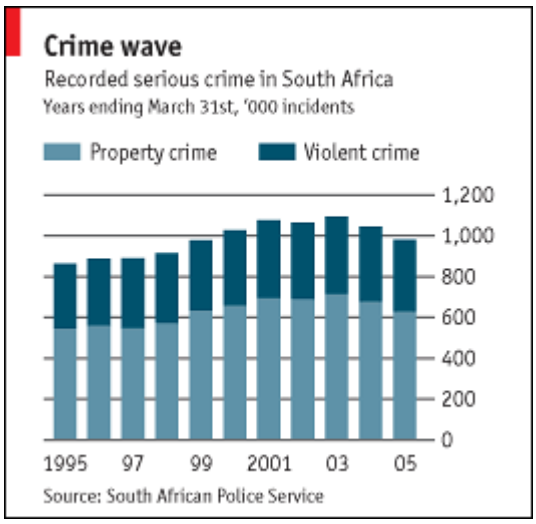
Aug 3rd 2006 | JOHANNESBURG
From The Economist print edition

Struggling to fight crime

Get article background

MOST South Africans are, unfortunately, no strangers to crime, but some recent incidents have shocked even them. A shootout after a bungled robbery in Johannesburg left four policemen and 11 criminals dead. There has been a wave of robberies, in shopping malls and banks, and even in airports. This week a four-year-old girl from a Cape Town township was found murdered.

All this comes on top of the minister in charge of safety and security, Charles Nqakula, saying that people who “whinge” about crime should leave the country. After all, don't the official statistics show that the incidence of many types of crime has been falling since the epidemic of the late 1990s (see our chart)? Mr Nqakula's comments probably reveal, as much as anything, an official frustration with the continuing public perception of South Africa as an unusually violent place.



But so it is. For, despite the improvements, the rates of violent crime, such as murder, rape and aggravated robbery, have scarcely moved. The United Nations claims that South Africa still has the highest rate of gun-related crime in the world except for Colombia. Most violent crimes are still committed by people known to the victims, but well-organised armed robberies have been multiplying. This breeds fear: private security guards outnumber police by at least two to one.

Why is it taking so long to reduce violent crime? One analyst, Antony Altbeker, says South Africa presents particularly difficult problems. The dramatic decline in murders in New York in the 1990s was mostly due to dismantling crack markets in specific areas. But in cities like sprawling Johannesburg, murders happen for a broader set of reasons and over a larger area. And criminals are an adaptable bunch: South Africa's success in fighting car theft may have made them turn to armed robbery instead.

South Africa spends a lot on its police, courts and prisons. In 2004 it spent 3% of GDP—or $130 per person—on criminal justice, compared with an average of 1% and $66 in the rest of the world. Yet this does not translate into more policemen on the beat. Although it has been recruiting more of them, South Africa still employs only about 260 police per 100,000 people, compared with an international average of 380. In the context of its crime levels, the comparison is far worse.

A stronger and more public commitment by the government to fighting crime would also help. The government hopes to reduce violent crime and robbery by 7-10% every year, but it has failed to convince people that it has a workable plan to achieve this, or that crime-fighting ranks high on its list of priorities. Nobody clearly stands up to take public responsibility for crime; Mr Nqakula and the police commissioner, Jackie Selebi, are largely invisible to the public eye. The minister's comment about whingers was met with outrage, especially by whites, many of whom felt that it was directed at them. This week Mr Nqakula was obliged to change his tune, saying that for the next six months the government would concentrate on combating organised crime.

One man who has staked his political capital on beating crime is Firoz Cachalia, the minister in charge of security for the provincial government of Gauteng, which includes Johannesburg and Pretoria. In July he

made a public splash of his six-month plan to deal with crime in the province. He has visited police stations and been on walkabouts with the public in shopping malls. He states clearly that crime levels are unacceptable, and expresses sympathy for victims, instead of suggesting that they pack their bags. The prospect of the 2010 football World Cup, when thousands of tourists will descend on South Africa, may persuade the national government to adopt more of Mr Cachalia's attitude and commitment.

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East Africa

Swimming against the tide

Aug 3rd 2006 | DAR ES SALAAM
From The Economist print edition

The battle against illegal fishing off east Africa's coast

FISHERMEN in El Wargadhi, a coastal village 160km (100 miles) north-east of the Somali capital Mogadishu, recently spotted a foreign fishing boat trawling just offshore. Incensed, they jumped into small boats to head it off. They were fired on before they could get near. No one was killed in the ensuing battle, except for sheep picking along the beach behind. Still, the locals were depressed. Foreign boats without flags or markings have been stealing their fish for years. Once, they could scare them off with a shout and a rocket-propelled grenade-launcher. No longer. These days, the fishermen say, the unmarked vessels carry 23mm anti-aircraft guns.

East African waters, off the coasts of Somalia, Kenya and Tanzania, have vast numbers of commercial fish species. As in other countries, east Africans enjoy exclusive fishing rights up to 370km (200 nautical miles) off their shores, but the rich pickings are attracting a growing number of intruders. The prize catch is the yellowfin tuna, which lures Taiwanese and South Korean longliners from the Seychelles into Somali waters, where the catch is a potential bonanza.

But the risks are high, especially off ungoverned Somalia. Even with anti-aircraft guns, some of the vessels are still captured by Somali “coastal patrols”. In a recent case, a South Korean boat, the *Dongwon-ho*, was released after four months in return for $800,000; “a fine”, the Somalis said, “a ransom”, to the South Koreans. Some longliners used to buy fishing licences in the past, but invariably from the wrong warlord.

The situation is only a little better in Kenya and Tanzania. In both countries a lack of capital has produced pitiful fishing fleets. Corruption, rife enough on land, is even worse at sea. Illegal and unreported fishing accounts for much of the catch. Marine conservationists say that pretty much everything is wrong with the fishing in east Africa. There is no compliance, limited monitoring and the boats use gear that rips up the seabed and, in some places, the coral reefs. Fish stocks are falling, and their indiscriminate human predators also slaughter numberless dolphins and rare turtles, which get snagged on the lines.

The EU has negotiated a deal to buy a share of African countries' fishing rights, and says it hopes this will help to regulate the industry. But European fishermen are as ruthless, if not more so, than any in Africa. The fear is that not enough money will flow back into the local economies, and too many European boats will fly flags of convenience to get around the regulations.

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Georgia and Russia

Fighting talk casts a summer shadow

Aug 3rd 2006 | TBILISI
From The Economist print edition

Georgia's prospects are still rosy, but could be imperilled by foreign meddling and domestic impetuosity

AFP

SUMMER in Tbilisi. The latticed balconies suspended over the Kura river alive with chatter; naked boys splashing in the fountains; the grimy courtyards overrun by unruly vines—and rumours of war.

If it were not for geopolitics and history, Georgia would be rich. Its 5m-odd population ought to subsist comfortably on its Black Sea summer resorts, winter skiing, agriculture and transit revenues. Under Mikhail Saakashvili (pictured above), who was swept to the country's presidency by the “rose revolution” of 2003, it at last has a chance of becoming a prosperous, free country. But the Soviet rule that followed the tsarist period bequeathed Georgia and Mr Saakashvili daunting problems—including Abkhazia and South Ossetia, two enclaves that broke away from Tbilisi in nasty wars in the early 1990s. Each summer, as the weather gets hotter, the political temperature rises in the enclaves.

This year's drama has included the Georgian government's operation last week to disarm a renegade warlord in the remote Kodori gorge, the only bit of Abkhazia at least nominally controlled by the Tbilisi authorities. That alarmed the Abkhaz leadership. There have been a string of murky assassinations—perhaps political, perhaps criminal—in South Ossetia. The tension there, says Matthew Bryza, an American diplomat, is “worrisomely high”, not helped, perhaps, by the sacking last month of Georgy Khaindrava, Georgia's conflict-resolution minister. Both Zurab Noghaideli, the prime minister, and Mr Khaindrava himself say this was for unrelated reasons. But his was a (relatively) conciliatory voice. Others saw his departure as a victory for the “party of war” within the government.

War, though, would be crazy—because it would in effect be war against Russia, whose support helped the two enclaves to achieve their quasi-secession and sustains them in it. The Georgian parliament last month told Russia's peace keepers to leave the enclaves, and the government may soon follow suit. After us, say (or promise) the Russians, there will be chaos. Some Georgians detect a Russian hand behind the opaque events in the Kodori gorge: it is “highly unlikely”, says Mr Noghaideli, that the wayward warlord acted alone.

In a way, though, Russia and Georgia are already at war, albeit a cold one. Russian ire with Mr Saakashvili and his Westernising policies have led to increases in the price of gas and the shutting-off of other energy supplies, border closures, disruption to the visa regime and a vindictive economic embargo. One example concerns Borjomi, a chalky, pungent Georgian water. It has, says Badri Japaridze, vice-president of the firm that bottles it, been drunk in Russia for 115 years. Russians were consuming half the production, until it was banned on questionable health grounds in May.

For its part, Georgia wants to reopen the bilateral trade deal the two countries have already reached in preparation for Russia's accession to the World Trade Organisation: unwise perhaps, if they were to end up with even worse terms. Mr Noghaideli observes defiantly that Georgia can have good relations with Russia “if we get down on our knees”.

But an actual war in South Ossetia or Abkhazia would mean disaster for Georgia, and not only because it would probably lose. It would make solving the territorial disputes impossible. And it would wreck one of Mr Saakashvili's dearest aspirations, and the one the Russians most resent: his plan to take Georgia into NATO. All that should be clear, even to Georgia's young, hot-headed defence minister, Irakli Okruashvili. Mr Noghaideli says the whole government is committed to peaceable solutions. “There is a party of war,” says Mr Khaindrava, the sacked minister, “but it is in Russia.”

Sabres are indeed rattling in Russia. The foreign minister, Sergei Lavrov, said recently that his country would use “all means” to protect its citizens in South Ossetia and Abkhazia. Thanks to Russia's generous ways with passports there, that applies to almost everyone in the statelets (though the Abkhaz, unlike the Ossetians, still covet full independence). During recent military exercises in the Russian north Caucasus, Russian officials made it clear that they had had Georgia in mind.

On the other hand, Mr Saakashvili and his team are anxious to do something about the enclaves, which are being creepingly incorporated into Russia. That may be part of a Kremlin plan, also involving Moldova (see article). Much more waiting risks losing the territories for ever. Yet irresponsible talk and ill-considered actions will have unintended consequences.

The lure of short, victorious wars

Georgians are a proud, nationalistic lot, and virtually all of them share Mr Saakashvili's ambition to reunite the country. But 70 years of Soviet rule have also left them cynical, and some see another motive in the government's urgency over the enclaves: to distract attention from its other travails.

There have been big achievements, chief among them an impressive crackdown on corruption, which largely explain the president's still-high approval ratings. More tax is being collected; economic growth will reach double figures this year, predicts Mr Noghaideli. Since 2004 Tbilisi's writ has run over Ajaria, another once-breakaway Black Sea enclave. In the summer months it now swarms with Armenian tourists. Apart from those of the Baltic countries, Mr Saakashvili's may be the most accomplished post-Soviet government now in office—even if many Georgians prefer to see themselves as a struggling European country than as a better-than-average ex-Soviet one.

But there have been disappointments too, not all of them part of the inevitable post-revolutionary come-

down. Poverty and unemployment are still rife. Even in Tbilisi life for many is tough. In the countryside, it is grinding.

Worse, Mr Saakashvili's enhanced presidential powers and the pliant parliament are encouraging his authoritarian streak. The police, claims Tinatin Khidasheli, an opposition activist, are out of control. Conditions in the country's over-stuffed prisons, says one well-placed Western observer, are medieval. A bloody prison riot took place in March. Accusations are made of unfair arrests and rigged trials, as in the case of a banker killed by interior-ministry employees: a test of the government's commitment to the rule of law, says Salome Zourabichvili, a former foreign minister now in opposition—and one that it looks like failing. Pressure on the media is the subject of various rumblings.

Mr Noghaideli dismisses them. “Georgia”, he says, “will be a successful democracy very soon.” Perhaps. But some recent developments rather resemble those in another country to which Georgians do not much like to be compared: Mr Putin's Russia. Like other governments in the region, Mr Saakashvili's sometimes shows signs of a dangerous contempt for the people it governs. He can still turn Georgia into the prosperous democracy it ought to be—the best way, anyway, to win back the enclaves—but, on both scores, he needs to be rather careful.

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Ukraine's political crisis

Oranges and apples?

Aug 3rd 2006 | MOSCOW
From The Economist print edition

Resolving a crisis, Ukraine's leader offers a job to his arch-rival

AP

Yushchenko: a paler shade of orange

AFTER more than four months of horse-trading and back-stabbing since Ukraine's parliamentary elections, and with demonstrations and counter-demonstrations taking place in Kiev, President Viktor Yushchenko seemed to have resolved his country's political crisis in the small hours of August 3rd. In what, to outsiders, looks like an astonishing turnaround, Mr Yushchenko agreed to nominate as prime minister Viktor Yanukovich, his Russian-backed rival in the rigged presidential poll that stirred the "orange revolution" in 2004.

Faced with a constitutional deadline, Mr Yushchenko had to choose between two unappetising options. One was to dissolve parliament and call fresh elections. The other was to agree to nominate Mr Yanukovich, whose candidacy had been agreed by a coalition comprising his Party of the Regions, the Communists and the Socialists. Although his decision may puzzle some foreign admirers, Mr Yushchenko has made the right choice, for two reasons.

The first is that Mr Yanukovich and his allies have every right to form a coalition and get their man in as prime minister on the basis of the election results, in which Mr Yanukovich's party won the most seats. The so-called "orange" parties—the president's Our Ukraine; the block of Yulia Tymoshenko, his firebrand ex-prime minister, and the turncoat Socialists—tried but failed to do so because of rancid personal rivalries. Keeping Mr Yanukovich out would have made it seem that Mr Yushchenko regarded "democracy" purely as a means of pursuing his own interests—as some other orange politicians seem to.

The other reason is that, if Mr Yushchenko had called fresh elections, it would have disrupted the country at home and discredited it abroad, only, probably, to produce similar results, but with more vitriol. Mr Yanukovich would probably still have ended up as prime minister (the job he held before the 2004 elections, but which now has increased powers under a constitutional reform agreed during the revolution). Our Ukraine might well have done even worse. Mr Yanukovich's victory only looked like a turnaround to outsiders. In reality, he has never ceased to enjoy rock-solid support from Ukraine's Russian-speaking east and south.

It is just possible that a governing axis of the two Viktors might help to stabilise the country, helping to bind east and west together. It may result in more sensible economic policy than a government that included the populist Ms Tymoshenko. And the president has tried to make Mr Yanukovich commit to a

set of policy principles designed to safeguard the pro-Western cause that Mr Yushchenko is committed to. On the other hand, there may be chaos.

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Turkish anti-Semitism

An unfamiliar spectre rises

Aug 3rd 2006 | ANKARA
From The Economist print edition

Turks have mostly treated the Jews well, but now anti-Semitism is growing

SHORTLY before General Yasar Buyukanit took up his job as chief of the general staff, some detractors looked for a trick to thwart his elevation. Finally they had it: they bombarded their compatriots with text messages, saying the general was a Jew, whose real aim was to steer Turkey even closer to Israel. In the event, the country's president, Ahmet Necdet Sezer, took the rare step of personally confirming the general's appointment rather than waiting for it to be formally announced by the top brass on August 1st.

AP

Buyukanit beats the conspirators

In a Muslim country whose elite, at least, has taken pride in the absence of anti-Semitism, it is a worrying sign that (falsely) describing a general as Jewish should be seen as a way to block his path. Another recent warning was a finding by the Pew Global Attitudes Survey that only 15% of Turks look kindly upon Jews.

Such attitudes are a far cry from the period 500 years ago when Ottoman sultans embraced Iberian Jews fleeing persecution from Catholic monarchs. Indeed, for most of the Ottoman era, Jews were a prosperous, loyal minority, conscious that Christian regimes would have been worse.

Under the Turkish republic proclaimed in 1923, the Jews have had some bad experiences—such as the crippling “wealth tax” slapped on all non-Muslims during the second world war; those who could not pay went to labour camps. But for most of the time since then, the 25,000-strong Jewish minority has quietly flourished.

Now, an increasing number of them say they no longer feel secure in Turkey, and recently some community leaders have received death threats. Fears began growing after Turkish suicide bombers with links to al-Qaeda blew up two synagogues in Istanbul in 2003. Although there has been no more terror, there are signs of anti-Jewish sentiment gaining ground—such as the hate literature that is appearing on bookstalls across the country.

Meanwhile, some weird conspiracy theories are going around Turkey. Last week, Recai Kutan, the leader of the Islamist Saadet Party, called on the government to examine claims that Israeli women

mountaineers might be responsible for an outbreak of a hemorrhagic fever which has (in reality) killed more than 20 people.

One Islamic newspaper quoted people in Bolu province as saying the Israeli visitors had smuggled in giant ticks to transmit the disease to humans. Also, mainstream dailies have speculated that behind Rupert Murdoch's recent acquisition of the conservative broadcasting station TGRT lie plans to promote Zionism and America.

Turkish officials note that such paranoia abounds all over the Muslim world. They also insist that if some ordinary Turks have negative feelings, it is towards Israeli policies and not towards Jews in general.

Meanwhile Turkey's defence ties with Israel, which mainly involve the secular elite and are hence somewhat fenced-off from populist complaint, are still robust. Whether that would remain the case if Turkey commits troops to peacekeeping in Lebanon—at a time when an ever-increasing share of Turks put their Muslim identity first—is another story.

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Business and politics in Germany

When nettles aren't grasped

Aug 3rd 2006 | FRANKFURT
From The Economist print edition

Rather than dashing for reform, politicians and businessmen are squabbling

YOU might think that a grand coalition, formed of the country's two main parties, would be able to take bold decisions. But with internal squabbles engulfing both the left and right, and palpable disappointment in the private sector which hoped for swifter change, there is a risk that Germany's masters will deliver the worst of both worlds, not the best.

As Berlin's politicians sweat through a hot summer, it is becoming clear that neither the left wing of the Social Democratic Party (SPD) nor the stiff-necked types in the Christian Democratic Union (CDU) can stomach their own government's plans for radical change in the country's health and tax systems. Meanwhile the employers who once ranked among Chancellor Angela Merkel's biggest admirers are becoming vehemently critical of her eight-month-old government's failure to push through reforms. Businessmen, for their part, are scrapping with each other over ethics.

Writing in *Bild*, a mass-circulation daily, two ex-chairmen of the Federation of German Industries last month lambasted Norbert Röttgen for planning to keep his seat in parliament—he is a CDU member—when he takes over as this industrial lobby group's next boss. The conflict of interest would mean a "dramatic decline" in the reputation of the organisation, they wrote. Mr Röttgen, after a week of dithering, opted to retreat into politics.

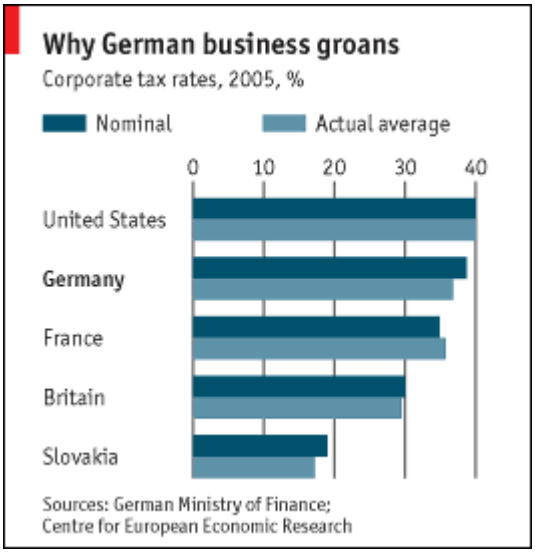
That was awkward for Reinhard Göhner, another CDU member of parliament, who has been managing director of the Confederation of German Employers' Associations for a decade. Despite much criticism, Mr Göhner tried to tough it out. But at the weekend Ms Merkel said a full-time, high-level job was incompatible with having a seat in parliament—a swipe at Mr Göhner. He duly vowed to drop one job or the other after the next election.

Is a fresh wind of integrity blowing through the corridors of power? Utz Claassen, head of the power utility EnBW, is under investigation for having invited local politicians to World Cup football matches. But Germans have probably been much more shocked by ex-Chancellor Gerhard Schröder's acceptance of a job with a joint-venture involving Gazprom, Russia's gas monopoly, after leaving office last year. The arrangement seemed all the more improper because the joint venture was partly cooked up by President Vladimir Putin and the former SPD leader himself.

The new morality may be good for Germany, but it could be awkward for the government. It has alienated the country's business lobbyists just when the government needs to keep its plans for corporate tax reform on the rails. Making matters worse, Peer Steinbrück, the finance minister, has alarmed companies with the threat of a tax on their interest payments. Such a tax, on operational activities rather than profits, horrifies business. Some lobbyists claim that it could bankrupt some firms, such as those that lease their equipment (the tax would apply to leasing contracts). Mr Steinbrück says he needs the extra money to balance a cut in the nominal corporate tax rate from 39% (see chart) to under 30%. He also wants to discourage firms from borrowing offshore to dodge taxes.

Further opposition is brewing in the states. Several state ministers have threatened to block the tax bill when they meet in the Bundesrat, the federal upper house, unless the bill is

changed to their taste. But despite the squabbles, Germany's economy is doing nicely, with corporate profits up, order books filling and unemployment falling (see article). Perhaps Germany is starting to resemble the old Italy where political turmoil hindered, but did not stop, the success of business.



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About sponsorship

Deregulation in Italy

A logjam breaks

Aug 3rd 2006 | ROME
From The Economist print edition

In the teeth of vested interests, a move to deregulate wins the day

NOBODY should underestimate the forces of resistance to change in Italy. Both the men charged in recent years with introducing some flexibility into the country's labour market—Massimo D'Antona and Marco Biagi—were later assassinated.

EPA

Just one more privilege: cantankerous cabbies in full voice

Yet, before heading off for their summer holidays, and despite demonstrations, violence and lockouts, Italy's members of parliament voted on August 2nd for a set of measures that will make life better for consumers and worse for vested interests. Taxi-drivers, chemists, lawyers, vets, notaries, banks and bakers all stand to lose privileges and protection because of a decree presented at the end of June by the economic development minister, Pierluigi Bersani. One consumers' group reckons it will save the average Italian family €1,000 ($1,270) a year.

It will free local authorities to increase the number of taxi licences and allow cabs to be driven by more than one licence-holder, thereby expanding the number of vehicles for hire in cities like Rome, where tourists often find themselves unable to get a cab in the centre on a Saturday night. Local authorities will also acquire the power to impose fixed fares for certain journeys so those same tourists are not ripped off on trips to or from the airport, as they are routinely nowadays.

The “Bersani decree” opens the way for non-prescription drugs to be sold outside chemists' shops (but only if a pharmacist is present). It abolishes minimum fees for lawyers and vets. It legalises no-win, no-fee practices for lawyers and lets them claim a proportion of the settlement in civil cases. It also ejects Italy's ever-present notaries from the business of buying a second-hand car, boat or motorbike. Non-Italians will be amazed to discover that many of the restrictions abolished by the decree existed in the first place. One entitled banks to levy a charge on customers who had the audacity to close an account.

Before unveiling his decree, Mr Bersani said that, at least where the promotion of real competition is concerned, the centre-left government of which he is a member would be more liberal than its centre-right predecessor, led by Silvio Berlusconi. Yet some of the main aspects of his legislation in its original form dealt not with liberalisation as such, but with reducing the cost of goods and services by encouraging bigger and more efficient businesses.

It was this that the most vigorous opponents of his decree, the taxi-drivers and chemists, latched onto in

their protests. The cab-drivers, who mounted two weeks of disruptive, occasionally violent, demonstrations took aim in particular at an attempt to introduce taxi fleets by allowing an individual to own more than one licence. In return for accepting more licences, they got that part of the decree withdrawn. Mr Bersani spoke of a “draw” but to many observers—including, it is said, the prime minister, Romano Prodi—it seemed more like a climb-down.

When the chemists took over from the taxi-drivers in the front line, they met stiffer resistance. Three one-day lockouts failed to budge the government from its insistence that the decree should contain an article enabling pharmacists to accumulate an unlimited number of licences and take a hand in distributing as well as selling drugs. This could herald the arrival of a Wal-Mart or Boots. Some suspect the government is thus doing a favour to the “red” co-operatives of central and northern Italy, which are well placed to expand.

The Bersani decree would have lapsed if it had not been approved by parliament within two months of its presentation, but it was wrapped into legislation containing a mini-budget, and made the subject of a vote of confidence in both chambers, a device which helped to ensure its passage.

In truth, the initiative faces little opposition in the ranks of the governing majority. Mr Prodi and his supporters have discovered liberalisation is not just good for the economy, but politically almost pain-free, even for a prime minister whose backers in parliament stretch far to the left. After all, most taxi-drivers, chemists, lawyers, vets and notaries are centre-right voters.

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Old and new information tricks

Disinformation

Aug 3rd 2006
From The Economist print edition

Cold-war propaganda wars return

AP

Lenin's Transdniestrian headquarters

SOVIET propagandists were experts in the art of disinformation: planting specious stories in obscure corners of the media, claiming, for example, that the CIA invented AIDS. Now Russia's interests are once again being promoted by information sources that look plausible, at least until you look closely at their antecedents.

Take, for example, the International Council for Democratic Institutions and State Sovereignty (ICDISS), a grand-sounding outfit that says it works on "result-oriented nation-building for new and emerging states". It produced a report in July supporting international recognition for Transdniestria, a breakaway region of Moldova that has had Russian support and Western disapproval since a brief civil war in 1992.

Slickly produced and heavily footnoted, the report was publicised in Russia and Transdniestria as evidence that influential outside opinion was conceding the case for independence. That would be in sharp contrast to all Western governments' policy to date, which has been trying, rather ineffectually, to reunite Transdniestria with Moldova.

The report says it is based on the work of a bunch of well-known international lawyers, including a serving State Department official, and academics from Stanford, Oxford and Harvard. It implies they attended a conference at the Beacon Hotel in Washington, DC, in April 2006.

The truth is rather different. For a start, the Beacon Hotel has no record of any such conference. None of the supposed outside experts attended it. Those contacted crossly denied involvement, though one, a doctoral student, says he did offer some advice. The ICDISS has now removed the names from the report.

That is puzzling enough. But the ICDISS is even odder. It has no address and no telephone number. Although its website, and an entry on a write-it-yourself encyclopedia, Wikipedia, claim that it was founded in 1999, there is no trace of its activities, or of its supposed staff members, in news databases or the internet before January this year. Since then, it seems to be solely involved in promoting Transdniestria. It claims to be based in America, but does not appear to be a charity there (for more on the ICDISS, see this article).

Its website is registered at a hotel address in Mexico, with a phone that does not answer, and operated from a server in Latvia. And that is positively illuminating compared with the report's other supposed publisher, the Euro-Atlantic Joint Forum Contact Group, which seems to have no existence other than its logo.

The report itself is written in professional legalese, peppered with Latin phrases and confident references to precedent. But some bits read awkwardly, with mistakes (telephone "centrals" rather than "exchanges") often made by Russians writing in English.

Reached by e-mail, the ICDISS programme director, identifying herself as Megan Stephenson, declined to talk on the telephone, or to give details of ICDISS financing, staff, headquarters or other activities.

The group wished to keep a low profile because of its previous involvement in protests in Venezuela, which had led to the arrests of its activists, she explained. A sentence on a dormant Venezuelan opposition website does acknowledge help from the ICDISS, although how, when and where is not clear. “If you wish to reach for the somewhat strained conclusion that our little group of volunteers is a Kremlin front, then so be it, but I again state clearly for the record that this is not the case,” insists Ms Stephenson.

The Transdniestria report is oddly similar to a recently published English-language “psychiatric assessment” of the Georgian president, Mikhail Saakashvili. This claims, falsely, to be endorsed by Western hospitals and research institutes. It portrays the Georgian leader (a Russian bugbear) as a paranoid hot-head.

One plausible conclusion is that the Kremlin is engaged in a new push to support Transdniestria and three similar statelets, as a response to the likely acceptance later this year of independence for Kosovo, a province of Serbia mostly populated by ethnic Albanians. Victor Yasmann, an analyst in Prague, predicts that Russia will invite the four to join the Commonwealth of Independent States, a Russian-led talking shop. That would be a half-way house to their full independence, a gain for the Kremlin and a setback for the West.

Certainly Moldova, poor, weak, divided and neglected like no other ex-communist country, seems to be hotting up. Transdniestrian politicians have blamed Moldovan provocateurs for a bomb attack on a bus in Tiraspol, the capital, that killed eight people on July 6th. Transdniestria will hold another referendum on independence on September 17th. Western countries will not recognise it, but Russia may.

In Moldova proper, the Gagauz minority (Orthodox by religion, Turkish by ethnicity), which is strongly pro-Russian, is restive. It may demand independence too. The economy is reeling from a Russian embargo on its main export, wine—which is also imposed on Georgia. Transdniestria's economy, based on arms, steel and trade (critics say smuggling) is thriving.

Faced with all this, some in Moldova despair of an independent future. Better, perhaps, to abandon dreams of joining a cold-hearted Europe, and fall in with Russia's wishes: a neutral and federal Moldova, with a special status for the Russian language. Others ponder dumping Transdniestria and rejoining kindred Romania, from which they were separated by Stalin in 1940. That idea seemed outlandish, until it was floated last month, with seeming seriousness, by Romania's president Traian Basescu.

Such thoughts are a distraction, argues Andrei Popov, at a think-tank in Moldova. The real task should be to reform the country's dismal justice system, local government and investment climate. Enviability is the best way to stability, not fretting over the means of failure.

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Foreign policy

The poodle's dilemma

Aug 3rd 2006
From The Economist print edition

Tony Blair's view of Britain's role in the world has left him vulnerable at home

AP

Get article background

FOR any prime minister, the moment when he stands before a bouquet of brightly coloured microphones and settles the affairs of the world to his own and others' satisfaction must help to make the defeats, compromises and fund-raising dinners on the way up worthwhile. Sometimes, though, the autonomy that prime ministers often exercise in foreign affairs can prove hazardous. While he was being feted in America this week, Mr Blair's decision to stick close to President Bush and refrain from trying to rein in Israel has left him looking more isolated and vulnerable at home than at any time since he came to power in 1997. That is odd because, unlike the invasion of Iraq or the operations in Afghanistan, Israel's war with Lebanon does not put British troops at risk.

Mr Blair's troubles spring instead from the conclusions he has drawn about how Britain should use its limited power in the world. Most Britons seem not to approve of them—or of his refusal to deploy two words: “disproportionate” and “ceasefire”.

One reason why he has not uttered either is that Mr Blair believes Britain's best chance of shaping events in a world where America is the only power that counts is to stick close to her ally in public and attempt to exercise influence in private. For Mr Blair, proof that this works came in 1999 when Bill Clinton used American firepower to prevent the Serbian army from marmalising Kosovo. Cultivating this influence became more worthwhile after September 11th, as America grew less reluctant to use its power abroad.

But the terms of this bargain have always been a hard sell in Britain. Mr Blair has to sound as if he agrees not just with Mr Bush, but also with Dick Cheney, the vice-president, and Donald Rumsfeld, the defence secretary. And he has to play the role of junior partner.

British newspapers were full of mockery when the “Yo Blair” conversation between America's president and Britain's prime minister overheard at the G8 meeting in St Petersburg was made public. The prime minister's suggestion that he could afford to return from Lebanon without a peace deal whereas Condeleezza Rice, America's secretary of state, could not was read as a humiliating rather than realistic

assessment of how the world works. And when critics argue that Mr Blair gets nothing in return for his loyalty, he must keep quiet about his successes. One such is said to be Mr Bush's original conversion to the merits of a Palestinian state; another, his willingness to seek UN approval before invading Iraq.

Another reason why Mr Blair has refused to call Israel's response to Hizbullah's original act of aggression "disproportionate" is that he has come to see each conflict that pits Islamist terrorists against sovereign states as skirmishes in the same battle. Where other Europeans tend to see terrorist attacks on Israel in the light of specific local grievances, Mr Blair, like Mr Bush, is increasingly inclined to see them as part of a global wrestling match. "9/11 in the US, 7/7 in the UK, 11/3 in Madrid, the countless terrorist attacks in countries as disparate as Indonesia or Algeria...the continuing conflict in Lebanon and Palestine, it is all part of the same thing," he told an audience in Los Angeles on August 1st.

This is not America's "war on terror", which British politicians have not, by and large, adopted. Instead it is what Mr Blair calls "a clash about civilisation" that pits progress against reaction around the world. When the lines are drawn in this way, it is clear to Mr Blair that Britain should be on Israel's side—and America's.

Whipping in

Mr Blair's colleagues do not see it that way, though. His cabinet's support has been thin or non-existent. Jack Straw, foreign secretary until recently, told Muslims in his Blackburn constituency that he thought Israel had acted disproportionately. Margaret Beckett, Mr Straw's replacement, has sounded uncomfortable defending Mr Blair's line. A handful of other ordinarily loyal ministers are unhappy. And Gordon Brown, the chancellor, has remained conspicuously silent, which is normally a sure sign that Mr Blair is in some difficulty.

Perhaps it should not surprise that politicians who expect to seek re-election do not leap to defend an unpopular leader who does not. While Mr Blair was in America, an opinion poll by Ipsos-MORI gave him his lowest-ever approval rating. But the silence also reflects attitudes to Israel in Britain, and in the Labour Party, that are very different from those in America.

In the past, Labour tended to be the party most in tune with Israel. Labour Friends of Israel, founded in 1957, remains an important parliamentary group, with 20 MPs as members. Recently, though, expressing solidarity with downtrodden Palestinians has animated Labour activists in much the same way as opposing apartheid in South Africa once did. In the 1960s Israel was praised on the left as a socialist paradise, and thousands of idealistic Brits tilled the soil each year on *kibbutzim*. Now people fired with similar ideals are more likely to go to Palestine, guided by the International Solidarity Movement and other pro-Palestinian groups, to stand in the way of Israeli bulldozers. The pro-Israel lobby is limited outside Parliament to a core constituency of some (but not all) British Jews and the odd neo-conservative intellectual.

Faced with isolation, Mr Blair is sticking to his line and hoping to win over his critics. His renewed emphasis this week on the importance of an independent Palestinian state should please his party. But on August 3rd he repeated that there was no point in calling for a ceasefire until a longer-term peace plan was in place.

Mr Blair has become identified with this war, and his position depends on how long and bloodily it continues. He has become used to the idea that how he will be judged as prime minister is bound up with what happens in Iraq. Perhaps he should now add another conflict to his list.

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Interest rates

A surprise increase

Aug 3rd 2006
From The Economist print edition

But only the timing was unexpected

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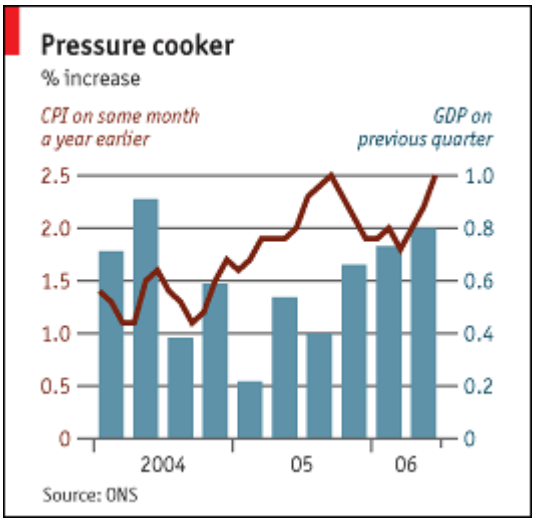

THE Bank of England caught financial markets on the hop this week by raising the base rate to 4.75%. Only a handful of City economists had predicted the quarter-point rise made on August 3rd. The increase reclaimed the cut made a year ago when the bank lowered the rate to 4.5%.

The decision may have been unexpected, but the case for an immediate rise in interest rates was formidable. Since the bank's monetary-policy committee met in July, when it voted unanimously to keep the base rate at 4.5%, inflationary pressures have intensified.

As recently as March, annual consumer-price inflation was 1.8%, below the government's target for the bank of 2.0%. By May it had risen to 2.2% and in June it jumped to 2.5% (see chart). Since the consumer-price index series began in 1997, it has only been this high on one previous occasion (last September).

Worryingly, inflation could well move even higher in coming months as the recent heatwave pushes up food prices and domestic energy costs rise yet again. British Gas, for example, has announced that it will start charging 9.4% more for electricity and 12.4% for gas early in September. George Buckley, an economist at Deutsche Bank, expects that such increases in households' energy bills will add to consumer-price inflation in the third quarter of 2006.

Not only has inflation picked up, but the recovery from last year's economic slowdown has also gathered momentum. The economy has now grown faster than its historic rate of 0.6% a quarter for nine months. GDP growth averaged 0.7% in the final quarter of 2005 and the first three months of 2006; and it picked up to 0.8% in the second quarter.

As a result, any margin of spare capacity that opened up in the preceding slowdown is being eroded. Furthermore the prospects for GDP growth look quite bright. In overseas markets, America may be slowing but the world economy and global trade are still growing strongly. In particular, the euro area, which purchases half of Britain's exports, is at last showing some vigour.

At home, too, there are signs that consumers are perking up. Retail sales rose by 2.1% in the second quarter of 2006, making this the most buoyant period for retailers for more than two years. Although special purchases connected with the football World Cup may have lifted spending temporarily, consumption is also likely to be boosted by the continuing resilience of the housing market. Mortgage approvals for house purchase were a higher-than-expected 120,000 in June, well above the average monthly level of 107,000 since the start of 2000. And the annual rate of house-price inflation accelerated from 5.0% in June to 5.9% in July, according to the Nationwide building society.

Another worry about the outlook for inflation is that the money supply has been growing so rapidly. Broad money (M4) rose by 13.5% in the year to June. This was the fastest growth for almost 16 years, and well above the rate of around 9% that the bank recently estimated to be sustainable over the long run.

There were some arguments for the bank to stay its hand. Sterling has recently been strong, which will help to abate inflationary pressures. More important, there is little evidence that these pressures are feeding through to the labour market. Indeed earnings growth continues to be remarkably restrained, in part because of the impact of higher immigration. Wages, excluding bonuses, are rising at an annual rate of 3.8%, according to the latest figures.

The bank's rate-setters decided to err on the side of caution, however. By moving early, they are sending a clear signal that inflation will be kept at bay. That will help to prevent a destabilising rise in inflationary expectations.

The bank is almost certainly not done with its monetary tightening. But the timetable for another rate rise is unclear. More light will be cast on this when the bank publishes its quarterly *Inflation Report* on August 9th. The City will scrutinise this even more closely than usual for clues about if and when rates will rise again.

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About sponsorship

Illicit drugs

Reefer madness

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A report on how Britain classifies illegal drugs: could do better

COMPARED with the bold campaigns in countries such as America and Sweden, Britain's war on drugs has been quiet, even reluctant. The number of men in prison for drug-related offences may have tripled in the past ten years (and the number of women has quadrupled) but the overwhelming sense is of a mission that has stealthily got out of hand. This week, a committee of MPs demanded a better plan.

The closest thing to a *casus belli* in Britain's drug war is a schedule of banned substances drawn up in the early 1970s. This divides the pharmacopia into three groups. “Class A” drugs, which sound like the best, actually include the worst—heroin and crack cocaine, together with milder fare such as ecstasy and magic mushrooms. Most amphetamines are “Class B”, as are dangerous but useful things such as barbiturates and codeine. Controversially, cannabis is a “Class C” drug.

As the MPs point out, the drug schedule tries to do several things, and achieves few of them. Mostly, it guides sentencing. The maximum penalty for possessing a Class A drug is seven years in jail; for possession of a Class C drug it is two years, although spliff smokers are likely to suffer nothing stiffer than a caution. The schedule is also supposed to reflect the relative dangerousness of drugs, defined in social and scientific terms; set limits on medical experimentation; and educate the public.

Why, by any of these criteria, is ecstasy a Class A drug? Nobody is quite sure. Its active ingredient, MDMA, was scheduled in 1977, more than a decade before pill-popping became an integral part of a British night out. Ecstasy harms fewer people than alcohol, as some of the experts who sit on the Advisory Council on the Misuse of Drugs, which keeps an eye on the drug schedule, have said. For that matter, all illicit drugs cause less harm than alcohol. Last year, hospitals treated 8,721 people for drug-induced mental or behavioural problems, compared with 43,903 people whose brains were addled by drink.

Nor is the drug schedule a good way of communicating with the public. Four years ago, the home secretary of the day, David Blunkett, announced that cannabis would be downgraded from class B to class C. Amid howls of outrage, he asserted this did not mean cannabis was a more acceptable drug. But, at the same time, he said there was no plan to downgrade ecstasy: such a move would send the wrong signal to young people. To make matters more confusing, the advisory council has a different idea about public opinion. Last year, it decided not to classify methylamphetamine as a class A drug, on the grounds that this might increase its appeal.

Junior high

16-24 year olds using drugs in past year

Drug	%	Classification
Cannabis	23.5	C
Cocaine	4.9	A
Ecstasy	4.8	A
Amphetamines	3.3	A/B*
Magic mushrooms	2.9	A
Anabolic steroids	0.3	C
Crack	0.1	A
Heroin	0.1	A

Source: Home Office *Depends on delivery method

Given this confusion, it is perhaps fortunate that the position of a drug in the schedule seems to have little effect on how many young people take it (see table). When cannabis was reclassified, prohibitionists forecast a dope-smoking epidemic. In fact, the drug became slightly less popular.

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Nuclear waste

The long view

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It will be decades before Britain finally deals with its nuclear litter

BRITAIN has been splitting atoms for over half a century. Yet in all that time, it has never decided what to do with the radioactive by-products of its nuclear-power industry, although successive governments have tried. About 80,000 cubic metres of the stuff are stored at various sites around the country, and with most civil reactors soon to be decommissioned, the problem is about to get bigger. Once all the reactors have been closed, the waste will total 478,000 cubic metres, much of which will be dangerous for thousands of years.

New Labour's efforts to solve the problem began with a paper in 2001 that led to the setting up of the Committee on Radioactive Waste Management (CoRWM) in 2003 to study the problem. On July 31st the committee published its final report.

The committee's technical conclusions will surprise no one. Like most other countries that have given thought to the matter, it plumps for “deep geological disposal”. It suggests burying the waste in a vast bunker up to a mile underground, in an area of stable rock where any leaks are unlikely to contaminate the water table, with interim storage in a dedicated facility while the cavern is being dug out. But the committee argues that getting the science right is not enough. Technically sound attempts to dispose of nuclear waste have foundered on the rocks of public opinion before—most recently in 1997, when a planning application by Nirex (an outfit that advises the government on Britain's atomic leftovers) to test the rocks at Sellafield, the country's biggest nuclear site, was turned down.

With that in mind, one of CoRWM's tasks was to come up with a way to sell a waste dump to a sceptical public. It concluded that residents would accept a dump beneath their backyards only if they had volunteered for it. To persuade them to do so, it proposes that towns and villages bid to play host to the waste, in return for some undetermined “compensation” from a grateful government.

Yet the focus on politics has not been popular with everyone. Two of CoRWM's members have left in the past year, alleging that the committee was focusing on public relations at the expense of hard science and wasting time on outlandish options such as firing waste into space. The House of Lords Science and Technology Committee said much the same.

Keith Baverstock, a health expert and one of the CoRWM members who left, criticises the committee's report for lacking detail: “If they'd sat down and concluded within six months that burial was the way forward, they could have come up with some specific proposals to take to the public,” he says. Instead, the report itself admits that by the time a detailed design has been sketched out and the bidding process finished, actual construction of the store may not start until at least 2035.

In the end, of course, worries over delays of mere decades seem petty and short-sighted next to the challenge of designing something to last for thousands of years or more. In Britain only a few ancient henges and barrows have endured for anything like the amount of time that a nuclear waste dump will be expected to last—Stonehenge, the most famous, is “only” 4,300 years old. How best, for example, to convey the concept of dangerous radiation to people who may be exploring the site ten thousand years from now? By that time English (or any other modern language) could be as dead as Parthian or Linear A, and the British government as dim a memory as the pharaohs are today.

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Company pensions

Running to stand still

Aug 3rd 2006
From The Economist print edition

Why pension deficits are proving so hard to shift

BRITAIN'S finance directors, beset in recent months by rising inflation and borrowing costs, should have been basking in the comfortable thought that at least one affliction was being cured. Company-pension plans, which swung alarmingly into deficit after share prices began to plunge in 2000, were supposed to be on the road to better health.

Instead, this week a series of blows rained down on companies and members of their defined-benefit pension plans. Lane Clark & Peacock, an actuarial firm, reported that the overall deficit in the British pension schemes of the country's 100 biggest quoted companies was £36 billion ($66 billion) in July. That was just 8% lower than a year earlier (see chart). Yet during their financial years ending in 2005, the firms had pumped some £12.1 billion into their pension funds—almost £1.70 for each £1 in benefits accrued that year. And rising equity markets helped boost pension-fund assets by £24 billion.

As stubborn as the shortfalls in pension provision appear, they are in fact incredibly volatile. The deficit on FTSE 100 British schemes jumped to £54 billion in January, yet by April, just three months later, it had fallen as low as £29 billion. This volatility arises because the present value of pension liabilities (which stretch decades into the future) is highly sensitive to moves in the corporate-bond yields that are used to calculate it. In January the yield on corporate bonds in Britain fell to a record low of 4.5% before climbing back to about 5.2%. As rates have fallen and recovered, so pension-plan deficits have swelled and waned. Lane Clark & Peacock reckons the aggregate deficit would be eliminated if real bond yields were to rise by one percentage point.

Even without higher yields, firms' more generous contributions should start whittling away at pension deficits. FTSE 100 companies stepped up the amount they paid into their schemes by 12% last year and are likely to increase the rate in coming years, says Bob Scott of Lane Clark & Peacock. At that pace, the aggregate deficit of FTSE 100 firms should be eliminated by 2012, he reckons, although some troubled companies may still be left with big holes in their pension schemes.

This cheery assessment overlooks two things. The first is that the bulk of Britain's pension deficit resides in thousands of smaller plans offered by little-known companies. The second is that firms big and small are threatened by a fundamental demographic shift that most have yet to adjust to. Britain's pensioners are proving a hardier bunch than expected.

On August 1st the actuaries' trade body adopted a new set of mortality tables drawing on data collected between 1999 and 2002, It forecasts yet another increase in life expectancy. In 1999 actuaries assumed that a British man retiring at 60 would on average live to the ripe old age of 84. They then raised that estimate in 2002 to 87. Now they figure he will live about six months longer.

What is good news for ageing folk is bad news for those who support them. Each increase in life expectancy of one year adds about £12 billion to the aggregate pension liabilities of FTSE 100 companies, says Peter Tompkins of PricewaterhouseCoopers, an accounting firm. To make matters worse, many pension schemes have yet to catch up with previous adjustments to mortality tables.

Not all companies disclose the mortality assumptions they use in calculating their pension liabilities, but those that do suggest that firms as a group are underestimating life expectancy. The third of the FTSE 100 companies that have gone public with their assumptions for their British staff reckoned, on average, that their employees would live to 85, says Lane Clark & Peacock. Updating that estimate could well add more than £25 billion to the FTSE 100 deficit, equivalent to more than two years' worth of company contributions at the current rate. Moreover, pensioners drawing an income of more than £13,000 a year are likely to live about four years longer than those receiving less than £4,500, says Deloitte Touche Tohmatsu, an accounting firm.

So it is not surprising that many companies are trying to reduce the risks of providing pensions by closing their final-salary schemes to new members (which three-quarters of FTSE 100 firms have already done) and, increasingly, to existing members. For example, Debenhams, a department store, said this week that members of its scheme would stop accruing benefits at the end of October. By 2012, reckons Mr Scott, more than half the plans provided by Britain's biggest firms will be closed to existing members.

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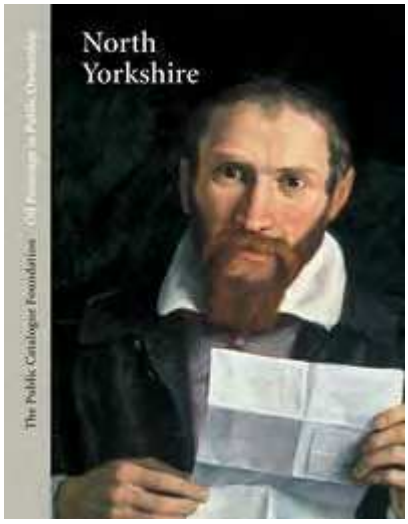
About sponsorship

Art

Hidden treasures

Aug 3rd 2006
From The Economist print edition

New efforts to bring publicly owned paintings to light



Annibale Carracci, at York Museums Trust

CHARLES SAUMAREZ SMITH, director of London's National Gallery, wrote shortly after Klimt's luminous portrait of Adele Bloch-Bauer was reportedly sold for $135m (£73m) in June that the combination of a booming art market and government tight-fistedness was ruining any chance public galleries in Britain might have of acquiring new paintings. “Art institutions become worthless”, he said, “if they are not able to add to their holdings and if their collections fail to reflect changing patterns of taste.”

Yet provincial British museums, hospitals and county-council offices are already crammed with paintings from past bequests and acquisitions that are rarely displayed. There are 40 works by Gainsborough in two small museums in Suffolk, a large collection of German Expressionists in Leicester and some of the finest modern Latin American art outside the Americas at Essex University. Indeed, public collections own so many oil paintings that more than 80% are stored away from view. “We own an astonishing collection of pictures of all dates and sizes, subjects and styles,” says Neil MacGregor, Mr Saumarez Smith's predecessor and now director of the British Museum. How can galleries and museums expect to convince the Treasury to finance further purchases when they cannot even show what they have?

The obvious, long-term solution is to rationalise existing public collections by selling some works and making more use of loans, exchanges, leasing, joint curating and travelling exhibitions to get the rest more widely seen. But first museums and galleries need to know what they own. Online indexes of public collections exist in Denmark and in Canada. There is no similar index of any kind in Britain, which is why the work of the Public Catalogue Foundation has become so important.

Launched in 2003 by Fred Hohler, a former diplomat, the PCF is gradually working its way across the country, county by county, cataloguing the oil paintings in British public ownership. Eight volumes have already been published; 12 are in preparation and more will follow.

Lack of money and other difficulties have hampered progress. The floor of the corridor to the painting stack at Christchurch Mansion, Ipswich, where many Gainsboroughs are stored, is so weak, for example, it can be used for only an hour a day. The museum employs no specialist art movers and its 1,000 paintings are not insured. In order to catalogue the collection, the PCF had to arrange insurance and employ its own technicians. Photographing it took nearly three weeks.

Each PCF volume costs about £65,000 to produce and private donors have borne most of the expense so far. Local authorities are beginning to contribute, but the Department for Culture, Media and Sport has come up with only two small grants of £15,000 each. The Heritage Lottery Fund (HLF), which finances schemes that emphasise public access, says the PCF does not fulfil its criteria.

Three developments may soon change the HLF's opinion. The first is that the PCF's repute is spreading. So successful have recent catalogues proved that provincial museums and counties are beginning to call Andrew Ellis, the PCF's chief executive, to ask when catalogues of their own collections can be published.

Meanwhile, Southampton's City Art Gallery is showing that it is possible to make money by leasing out works of art. It earns more than £40,000 a year renting some 300 of its paintings to local institutions under a scheme known as Artlease. Other museums want to do the same, but they need to know what

they hold first.

Third, the BBC is considering publishing the PCF catalogues on its interactive website. This would be a particularly important advance. Many provincial collections are made up of works by local painters and of local subjects. Some are well known: Constable and Gainsborough in Suffolk, for example. But many are not. Posting the nation's paintings on the BBC's website will allow people to find out what is held where, and perhaps elicit information about private collections. This is real public access. Ministers and lottery moguls should raise a cheer—and reach into their pockets to make it happen sooner.

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Churchmen and the environment

A new testament

Aug 3rd 2006 | LONDON AND MANAUS
From The Economist print edition

Anglicans, a diverse species, turn British Christianity green

“THINK of mankind as the passengers on a ship, with a few people cruising along in first class, unaware that just below, a much larger number are enduring all the fumes and heat of the steerage deck,” declared Bishop James Jones of Liverpool. A keen evangelist who likes catchy phrases, he used the metaphor to denounce not just world poverty but also the unequal way in which access to ecological goods such as clean air and water is parcelled out.

In fact, his listeners did not have to use much imagination; they were scientists, ecologists and churchmen travelling on a flotilla of river-boats, living in somewhat varying degrees of comfort as they chugged their way through Brazil's endangered heart. For a week last month, the man from Liverpool and top Christian clergy of various hues did their best to restore to the Amazon eco-system whatever it had lost in colour, plumage and biodiversity: as they strode through the rainforest, the Liverpudlian's Anglican purple mingled with the red of two Catholic cardinals and the sombre black of an Orthodox Patriarch (Bartholomew I, based in Istanbul, who organised the whole thing).

In a whole series of ways—some practical, some intellectual, some a little eccentric—the Church of England is making a serious effort to turn green. While all Britain's religions profess some concern about the fate of the earth, it is probably the Anglicans who lead the way.

In this matter, at least, Anglicanism's famous breadth—ranging from evangelicals to cool, cerebral types—has been a strength. With his folksy style, Bishop Jones provides a link to newly green evangelicals in the United States. Meanwhile, intellectual figures like Rowan Williams, the Archbishop of Canterbury, and Bishop Richard Chartres of London—both influenced by eastern Orthodox theology—have provided new tools for Christian thinking about the planet.

The Bishop of London, for example, talks about the ecology of knowledge; he argues that, metaphysically speaking, mankind has never ceased to “eat from the wrong tree”, as Adam did in the Garden of Eden. The answer, he says, is to try harder to distinguish mere knowledge from wisdom. Apart from his intellectual side, London's spiritual overlord has a gift for playfully provoking the media: he recently suggested that flying unnecessarily or driving gas-guzzlers might be a new way of living in sin. Journalists spent weeks figuring out what he meant, and he made good use of the ensuing publicity.

Claire Foster, the Church of England's environmental officer, has scoured the country for three years trying to impart these ideas, and some more practical ones, to packed church halls. She finds that concepts such as sin, sacrifice and repentance—which people had either forgotten or become embarrassed to use—have regained meaning in relation to the environment. While Old Testament priests made animal sacrifices to keep the world's covenant with God intact, “living sacrificially” today can mean avoiding excessive consumption and remembering man's duty to future generations. Such ideas could help to rebuild crumbling congregations.

At a more down-to-earth level, the Church has embarked on a massive environmental audit of all its places of worship and administration—with the pledge that most of its 16,000 premises will have reduced their “footprint” by 2008. And in any case, not everybody wants a super-intellectual approach, Miss Foster finds. “The diocesan finance officers say they don't want theology, they just want to be told how to put in new light bulbs.”

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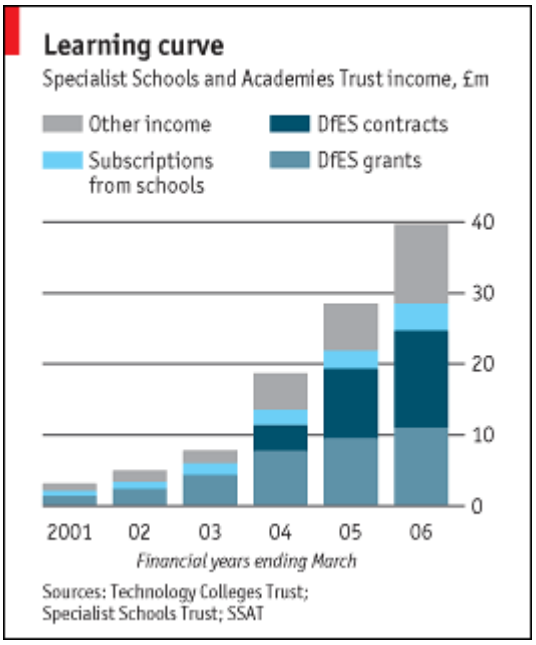
Specialist schools

A question of trusts

Aug 3rd 2006
From The Economist print edition

When charities compete with businesses

POLITICIANS of most hues tout the merits these days of the "third-sector"—charities and not-for-profit organisations—in delivering public services. Their enthusiasm could be diminished by a row brewing over the Specialist Schools and Academies Trust (SSAT), a charity entrusted with the prime minister's cherished goal of improving secondary-school education by involving private businesses. A body set up as a charity to implement government policy is accused of crowding out the private sector unfairly. Where do the limits lie?



Set up in 1987 to oversee the Tory government's city technology colleges, when Labour took power the SSAT began raising money for specialist schools. Two years ago it was enlisted by the government to find sponsors for new city academies to replace failing schools. Chaired by Sir Cyril Taylor, the trust describes itself as "the leading national body for secondary education in England, part funded by the DfES [Department for Education and Skills], delivering the Government's Specialist Schools and Academies programme". The DfES calls it a "valuable and trusted" partner and the trust's latest report begins with a paean from Tony Blair.

The SSAT is growing fast (see chart). In addition to the core grant that it receives from the government for its work in secondary schools, it is winning increasing sums for "additional programmes". In all, the SSAT's government funding has increased from £1.5m in 2001 (46% of the total) to £24.8m (63%) in 2006.

Meanwhile the trust's income from other activities is rising too. This includes fees charged to schools for services such as advice on preparing for inspections and training—things that were traditionally provided by private-sector firms.

Rival education businesses accuse the SSAT of "mission creep". Three big firms and two smaller ones, all critical of the SSAT, asked not to be identified for fear of losing government business in future. They have, broadly, two concerns.

The first is that, because of its central role in implementing the government's education reforms, the SSAT is being given wodges of cash for other work too that could have been put out to tender. One example is the Enterprise Project launched last year, which teams entrepreneurial students with young businessmen. At least one plausible private-sector firm says it would have tendered for it. The SSAT has won just one contract, the £3m Leading Edge Partnership Programme, in open competition in the past four years. Recently, the SSAT has taken to calling such contracts "additional grants" instead.

The second concern is that the SSAT may have an unfair edge when contracts are put out to tender. From its core grant-funded work, it holds precious data about schools that its rivals cannot buy and is thus at an advantage in bidding (and in getting work directly from schools). Its overheads, too, are lower because it is a charity.

Such criticisms are not confined to the SSAT: they lie at the heart of the growing debate over the role of

the third sector in delivering public services. Should tax-favoured charities bid against profit-making firms? The British Council, for example—a quango, and charity, that represents Britain's cultural interests abroad—charges for English-language tuition. A recent report for the Foreign Office said that the council's business activities required constant monitoring lest they annoy both private providers and foreign tax authorities.

Sir Cyril, the SSAT's chairman and prime mover, defends its charitable status, although he agrees that it is a “very unusual body”. He is proud of his charity's record in “winning” government contracts. Of course it can undercut private providers, he says: all the council members volunteer their time and those who work for the trust on salary are paid little. The SSAT gives good value for money, he asserts, and improves the quality of education.

Sir Cyril has a point, but it has been overshadowed of late by another matter. The SSAT has been linked to a police investigation into whether political parties have sold honours for cash (or sponsorship of city academies). Both a former council member, Des Smith, and the SSAT's president, Lord Levy (Mr Blair's friend and chief fundraiser), have been arrested and released in connection with the inquiry.

The SSAT and its private rivals all belong to the Confederation of British Industry, which is taking members' concerns about the trust seriously. It says it welcomes competition between charities and private and public bodies, but worries that businesses often lose out. On July 5th it sent a memo to business members of its panel on education and children's services saying that the activities of the SSAT raise “potential competitive neutrality issues” and asking for their views. The panel is expected to discuss the matter next month.

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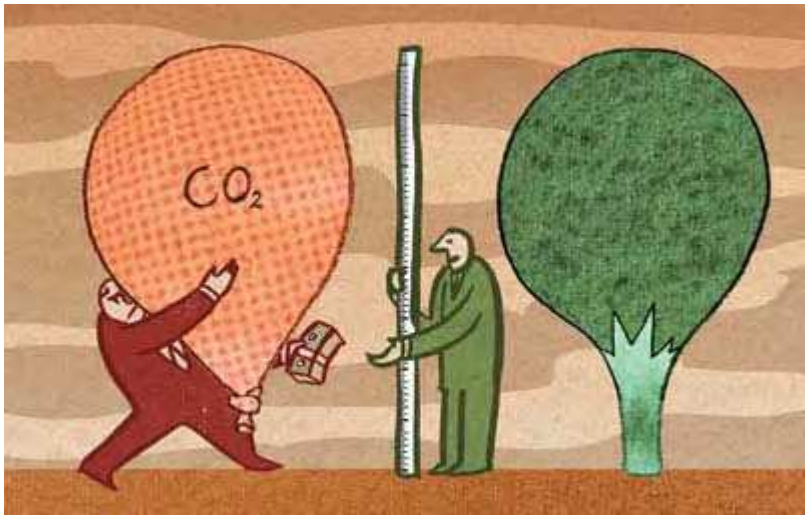
Emissions offsets

Upset about offsets

Aug 3rd 2006
From The Economist print edition



As the business of offsetting emissions grows, it is coming under more scrutiny

Get article background

AT A get-together in Los Angeles on July 31st, Tony Blair, Britain's prime minister, and Arnold Schwarzenegger, the governor of California, resolved to investigate the use of market mechanisms to combat global warming. But many of their compatriots are already busily (and sometimes voluntarily) buying and selling emissions of the greenhouse gases that are heating up the planet. This has created a new, fast-growing and controversial industry: emissions offsetting.

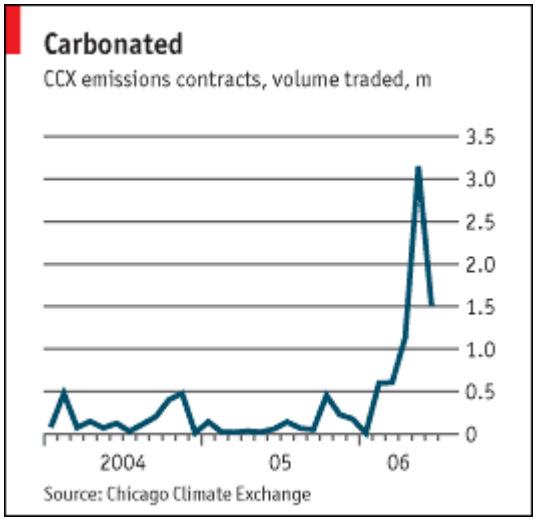
Offsetting happens when one individual or organisation pays another to reduce emissions of greenhouse gases (carbon dioxide and methane, for the most part) on its behalf. Those who wish to trim or eliminate their emissions, but find it too expensive or difficult to do so, can thus buy the appropriate amount of offsets instead. In theory, offsetting should reduce the cost of combating global warming, by giving those for whom it is cheapest and easiest to cut emissions most incentive to do so.

Offsets are suddenly in demand. FIFA, the body that governs world football, bought some to make up for the emissions associated with the World Cup. The Rolling Stones and other bands buy them to compensate for the greenhouse gases they emit while on tour. Al Gore, a former American presidential candidate turned environmental activist, offsets his own emissions, while Paramount, a Hollywood studio, is offsetting the emissions involved in making his film about global warming, “An Inconvenient Truth”. All kinds of organisations, including Bank of Tokyo-Mitsubishi, the British government and the Temple Emmanuel, a synagogue near Washington, DC, have pledged to go “carbon neutral”, by reducing their emissions as much as they can, and buying offsets to compensate for the remainder.

About $2.7 billion-worth of offsets were sold last year, according to the World Bank, representing 374m tonnes of carbon-dioxide emissions. The vast majority of offsets are used to meet rich countries' obligation to cut their emissions under the Kyoto protocol, a treaty on global warming. But voluntary offsets are growing rapidly, albeit from a low base. Bill Sneyd, of the Carbon Neutral Company, Britain's biggest offset firm, reckons volumes rose from 3m-5m tonnes of carbon dioxide in 2004 to 5m-10m tonnes last year, and will rise even faster in the future, to as much as 50m tonnes this year and 100m next.

Moreover, the market for voluntary offsets is evolving rapidly. Until now, most buyers were firms with relatively low emissions, such as banks, hoping to generate good publicity and draw in environmentally minded customers. But others are beginning to get involved. Various emissions-belchers have joined the Chicago Climate Exchange (CCX), which requires them to eliminate or offset 6% of their emissions by 2010. Its membership has grown from 23 firms at the end of 2003 to 210 now, including such corporate titans as Motorola, DuPont and Ford. The volume of offsets traded on the exchange has risen accordingly (see chart).

Other heavy emitters are buying offsets and passing the costs on to consumers, or arranging facilities for customers to offset by themselves, should they want to. BP, for example, offers more expensive offset petrol in Australia, while British Airways gives passengers the option to offset emissions from flights through Climate Care, another British offset firm.



Richard Sandor, the head of CCX, says members join for a variety of reasons: to improve their image, to gain insight into a nascent industry, to prepare for future regulation, or to appease green shareholders, customers or staff. Swiss Re, a big reinsurance firm, says it is going carbon neutral partly to fight global warming, which damages its business by causing more extreme weather, and therefore more claims against its policies. But it also hopes to gain experience of a new type of risk which it can manage on behalf of its customers.

Sellers of offsets are an equally varied bunch. There are firms, charities, NGOs, community groups and international agencies such as the World Bank. Some plant trees to soak up carbon dioxide. Others prevent existing trees from being chopped down. Replacing fuel-guzzling stoves in China and India with more efficient ones is popular, as is collecting methane from rubbish dumps and using it to fuel power plants. NativeEnergy, Mr Gore's favoured supplier, offers offsets from wind turbines on farms owned by Native Americans.

The price of offsets varies wildly too, from a few cents to $27 per tonne of carbon dioxide, according to the World Bank. The wide range suggests that some offsets are not as good as others. Environmental groups believe many are suspect. Friends of the Earth, for example, says the efficiency of stoves is irrelevant if they burn renewable fuels such as dung or wood, as those in poor countries often do.

Offsets based on forestry are perhaps the most controversial. Deforestation accounts for roughly 20% of the world's greenhouse-gas emissions, which reforestation could potentially counter. But trees, once planted, can die and decay or be chopped down for firewood, releasing the carbon they stored back into the atmosphere. And digging holes to plant saplings releases greenhouse gases from the soil. All of this makes the net benefit of reforestation extremely difficult to measure. The Carbon Neutral Company, which began life as Future Forests, used to invest only in forestry schemes. But as misgivings about the merits of reforestation grow, it is turning to technology projects, which will make up 80% of its portfolio this year.

The Kyoto protocol includes strict rules on the design, measurement and monitoring of the offsets it permits rich countries to buy from poor ones to meet their targeted cuts in emissions. But there are no accepted norms for voluntary offsets. Many offsetting firms develop and even police their own regulations—a licence to print money, if abused. HSBC, another carbon-neutral bank, finds the market for offsets so murky that it bypasses all brokers and devises its own projects.

Several NGOs have developed independent standards to determine whether forestry offsets really deliver the promised emissions reductions. Others support a system called the Gold Standard, which mimics Kyoto, but adds requirements to use certain technologies and conduct consultations with local people in the name of “sustainable development”. Meanwhile, a rival standard is being drawn up by the International Emissions Trading Association and the Climate Group, which will focus solely on emissions reductions, no matter how or where they are achieved. Competition between such standards might help bring clarity to the business of offsetting. The market, it seems, will determine not only where emissions reductions are made—but also how they are defined.

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Retailing

Heading for the exit

Aug 3rd 2006 | FRANKFURT
From The Economist print edition

After struggling for years, Wal-Mart withdraws from Germany

BACK in 2003, some academics at Bremen University published a study entitled “Why did Wal-Mart fail in Germany?” Three years later, the news finally reached Bentonville, Arkansas, the home of the world's biggest retailer. Last week Wal-Mart pulled the plug on its German operations, selling its 85 hypermarkets to Metro, the local market leader.

EPA

Piled high, sold cheap

It has been a sad tale of errors ever since late 1997, when the American giant bought one prestigious German store chain, Wertkauf, and then gobbled up another, Interspar, without really examining what it was buying. Competitors naturally trembled, given Wal-Mart's reputation as a discounter and the winning ways of its greeters and grocery packers. But they soon breathed more easily, as Wal-Mart went on to get nearly everything wrong in what the Bremen boffins called “a textbook case of how not to enter a foreign market”.

The first error was to appoint a boss for Germany who spoke no German. Not only that, he insisted that his managers work in English. The next boss, an Englishman, tried to run the show from England. The men at the top misunderstood both the employees and the customers. German shoppers like to hunt for bargains on their own, without smiling assistants at their elbows. Other surprises for Wal-Mart were Germany's short shopping hours, including almost no Sunday trading, and fierce competition from Aldi and Lidl, two discount chains. Kaufland, Lidl's sister operation, was in direct competition with Wal-Mart's hypermarkets.

Wal-Mart's biggest error in Germany, according to Jürgen Elfers, an analyst at Commerzbank Securities, was to think small and ignore Kaufland. Wal-Mart tried to get its existing stores right instead of building critical mass, which would have meant opening or buying another 400 or so hypermarkets. Its infrastructure in Germany, which involved two headquarters (for a while) and three logistics centres, piled up costs without achieving economies of scale. On the German Monopoly board, Wal-Mart picked the wrong street names and lost, says Mr Elfers. It only once published its results for Germany, in 2003, when it lost €487m ($550m). So it is safe to assume that it never made a profit. The sale price to Metro was not disclosed, but Wal-Mart says it will take a one-time charge of €1 billion on completion.

The pull-out leaves the American giant with only one European operation, in Britain, where it owns Asda, the country's number two supermarket chain. In May it also pulled out of South Korea, where it had a

loss-making network of 16 stores. Its Japanese operation could be next, though its partner there, Seiyu, is well established.

Wal-Mart may be right to forget about Europe. It has a growing joint venture in China, though there is a threat that its 30,000 employees may be unionised—anathema in Bentonville. In India it has a procurement operation and big plans, although foreign investors cannot own supermarkets. And it is, of course, market leader in America, Canada and Mexico.

In Germany, Metro will add Wal-Mart's hypermarkets to its existing Real chain of 288 stores. Ironically, eight years ago Wal-Mart considered buying Metro and canvassed the support of its chairman. To put a stop to persistent rumours of a merger, Metro eventually fired him.

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Economist.com BUSINESS
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Japan's food industry

Surf 'n' turf

Aug 3rd 2006 | KAGAWA AND WAKAYAMA
From The Economist print edition

The traditional farming and fishing industries are reinventing themselves

“COSMETICS was the furthest from our mind,” says Takashi Tokuyama, a soft-spoken former brewer of sake, a rice wine, now turned cosmetics-maker. “We just wanted to explore the untapped potential of rice.” Using a series of different yeasts and lactic acids to ferment rice, Mr Tokuyama, president of Yushin Brewery, a tiny sake brewery in Kagawa, on an island in the west of Japan, created a range of rice extracts that he claims have special water-retention qualities ideal for skin-care products. His inventions, patented in 2001, sparked a bidding war in Japan's fiercely competitive beauty industry.

“Previously, cosmetics used other natural ingredients like collagen—but this was truly revolutionary,” says Midori Sato of Kose, a leading cosmetics company, which won the rights. Kose uses the rice in a line of moisturisers, sales of which have boomed since they were launched in 2004. Under a scheme called the “rice power project”, for which Yushin received government funding, the brewery has also developed its own in-house line of skin-care products. As a result, its sales have almost quadrupled in the past three years. That is just as well: sake, once Japan's top alcoholic drink, has lately been displaced by shochu, a distilled drink made from barley, rice or sweet potatoes. Rice holds tremendous marketing power because it is part of Japan's cultural identity. “Rice, to us Japanese, has a very soft and gentle image,” says Ms Sato.

The popularity of rice-based cosmetics is part of a broader shift towards more “natural” products. In particular, Japanese consumers, like those elsewhere, are now much fussier about the use of pesticides and other chemicals in food production. This has helped Japan's agricultural exports, mostly because in other parts of Asia, Japanese food is considered to be of high quality and safe to eat. The agriculture ministry wants to double agricultural, fishery and forestry exports in the next five years. Accordingly, subsidies have been shifted away from small-lot farmers towards larger, more efficient operations. At the same time, the ministry is using subsidies to encourage new ideas such as rice-based cosmetics.

Another innovator is Kyusai Farm Shimane, a company based in Shimane, in western Japan. While Tsuneo Hasegawa, its former president, was recovering from cerebral thrombosis, he searched for ways of improving his health. This led him to kale, a dark green member of the cabbage family, chock full of minerals and vitamins, which had never been grown in Japan before. He subcontracted kale production to small farmers and then squeezed the vegetables to make a “green juice”.

Though it tastes awful, the juice took off thanks to a commercial in which an actor known for playing hardmen bravely drank the juice and then asked for more. Though it now has some 200 or so competitors, Kyusai, which insists on its kale being free of pesticides and additives, has the largest share of the market, with 3.5m households drinking its juice. Its parent company, Q'sai, also developed testing equipment to ensure that its products are free of agricultural chemicals, and can test for nearly 500 of them simultaneously. It now offers a testing service to other firms, which helped to increase its profits by 160% in the year to February 2006.

Similarly, innovation is also under way in the fisheries industry. Marinoforum21, a non-profit organisation in Tokyo, promotes innovation by helping firms to win subsidies and linking them up with technology experts. Takagi Kogyo, a small fishing-net company, hopes to replace the high-intensity discharge lamps—used on fishing boats to attract squid—with energy-efficient blue-light diodes. Powering such lights would require half as much fuel.

Another breakthrough was the creation of the world's first completely farm-reared bluefin tuna, a rare and expensive fish (selling one can feed a fisherman and his family for several months). As well as breeding the tuna in captivity, Hidemi Kumai and his team at Kinki University managed to raise the

hatched fry to adult-size and breed a third generation—what scientists call a completely cultured life-cycle. The hope is that such innovations will open up new markets for the fisheries industry too, allowing Japan to preserve its agricultural and piscatory traditions, but with a modern, high-tech twist.

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Advertising

On the spot

Aug 3rd 2006
From The Economist print edition

A start-up allows television advertising to be more finely targeted

TELEVISION and internet advertising are at opposite ends of the advertising spectrum. The former provides broad, indiscriminate exposure, at a high price; the latter allows careful targeting so that a specific niche can be reached cheaply. But Spot Runner, a start-up based in Los Angeles, thinks it has found a way to provide the best of both worlds. Its service makes it affordable for small businesses to buy TV advertisements aimed at local markets.

The firm offers a selection of thousands of pre-designed ads—suitable for accountants, lawyers, copy shops and so on—which are adapted for each customer. Because the ads run only in a small region, the cost is modest. Ashish Vashi, a dentist in South Pasadena, California, paid a set-up fee for his ad (the standard price is $499) and now pays about $10 each time it is shown locally on a variety of stations. “We're not talking about public-access TV,” he says, since Spot Runner sells spots on channels such as ESPN, Bravo and CNN. Mr Vashi was worried that the boilerplate ads would be cheesy, but was “pleasantly surprised” at the quality.

Small firms may have limited marketing budgets, but there are some 26m of them in America, and local advertising is a $100 billion market. “If you get even a little tiny chunk of this, you're doing pretty well,” says Greg Sterling of Sterling Market Intelligence, a consultancy. Spot Runner says its customer numbers have grown by 50% a month on average since it launched in January.

But don't advances such as digital video-recorders make it harder for TV advertisers to reach viewers? True, says Peter Kim of Forrester, a consultancy, but locally targeted ads could buck the trend. “It's the irrelevance of so much advertising that causes people to turn off,” he says. “Spot Runner moves in the direction of making things more relevant.”

This week Spot Runner announced a deal with JWT, a big American advertising agency. Marian Salzman, JWT's chief marketing officer, says this will help its clients hit specific markets: “We got so focused on global—but how do you drive people to Walgreens in Chicago?”

Spot Runner's founders, Nick Grouf and David Waxman, still have work to do. Like any technology start-up, Spot Runner faces the difficulty of explaining what it offers and attracting new customers. But not to worry, says Mr Waxman. Spot Runner is now promoting itself in a variety of local markets—using its own service, of course.

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Picture messaging

Lack of text appeal

Aug 3rd 2006
From The Economist print edition

Despite the success of texting, picture messaging is a flop

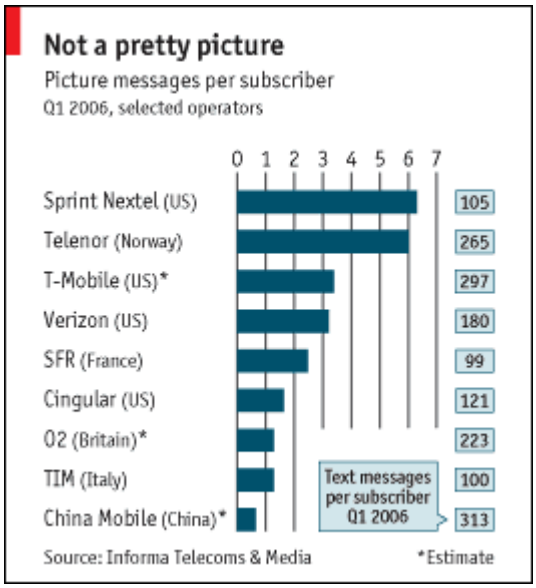
GO TO any sporting event or music festival this summer and you will see spectators holding their camera-phones aloft, snapping photos. Unfortunately for the mobile-phone industry, however, very few fans will use their handsets to send those snaps to their friends via "multimedia messaging service" (MMS), or picture messaging. Network operators built fancy new data networks and pressed camera-phones into their customers' hands in the hope of extending the popularity of text messaging into a lucrative new format. But, says Stéphanie Pittet of Gartner, a consultancy, MMS has proved "a major disappointment". Indeed, though billions of text messages are sent every day, the number of picture messages sent is so tiny that many firms keep the figures secret. Why has picture messaging failed?

When the first MMS services appeared in Europe in 2002, advertisements made picture messaging look quick and easy, but the technology was not ready. Few handsets capable of sending pictures were available, photos sent from one phone could not always be viewed on another, and rival operators were slow to link their networks properly so that their customers could exchange pictures as easily as texts.

By the time these teething troubles had been sorted out, the operators had moved on to promoting other, snazzier services such as music downloads and their latest obsession, mobile TV. According to In-Stat, a market-research firm, people are still put off picture messaging by low image-quality, fiddly menus and slow transfers. Cost is another deterrent: sending a picture typically costs four times as much as a text.

Pyramid Research, another market-research firm, predicts that MMS revenues will grow from $4.7 billion in 2005 to $9.4 billion in 2010 as the number of people with camera-phones grows and service quality improves. Less than expected, but still not to be sniffed at—except that texting brought in $49.4 billion last year and will yield $76.5 billion by 2010, Pyramid predicts.

Some operators have promoted MMS by cutting prices; others have tried to encourage adoption by promoting new uses, such as uploading images to the web. But the average number of messages sent by each subscriber is still minuscule (see chart). And as internet standards permeate further into mobile phones, people may start sending photos to and fro using e-mail instead. In Japan and South Korea, they already have. "MMS is a dead end," says David Chamberlain of In-Stat.



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AOL

You've got mail—for nothing

Aug 3rd 2006
From The Economist print edition

AOL announces a new strategy, again

Get article background

THIS summer, AOL, the internet division of Time Warner, a big American media company, learned what the web can achieve. A customer named Vincent Ferrari called AOL to cancel his subscription to its internet-access service. In the face of extraordinary resistance from the firm's customer representative, he had to repeat his request 21 times. Mr Ferrari posted an audio clip of his struggle on the internet and it became a huge hit.

The episode may prove to have been the firm's nadir. This week Time Warner announced a daring new strategy for AOL, which if successful could mark a clear break with its difficult past. AOL will start giving away its software, e-mail and security products free to all broadband internet users. By doing this, AOL is giving up many hundreds of millions of dollars (which will be offset by lower marketing and other expenses). But subscribers are defecting from the firm in droves in any case. In the first half of 2006 it lost 1.8m of them, and it now has 17.7m subscribers in America, down from 28.6m at the end of 2002.

This way, Time Warner hopes that AOL can maintain a relationship with people who leave. Its broader plan is to build a new internet-advertising business to replace the revenues from its declining internet-access side. That was already its strategy before this week's news. The problem was that most of AOL's page views were being generated by the firm's subscribers rather than by random internet surfers. In the second quarter, AOL said, its own members made up 36% of unique visitors to its network of websites, but generated 80% of page views. As subscribers left, therefore, AOL was losing page views too. Its new strategy will hasten the death of its access business, but should give its advertising side a better chance to grow.

Will it work? There is a risk that AOL will lose revenue from subscribers even more quickly than it expects, which would damage its parent's earnings and upset Wall Street. At the moment, AOL assumes that many of its dial-up subscribers will stick with their slow internet access and continue to pay for its services. But these people may make more effort to switch to broadband once they see other people paying nothing for AOL's services. And AOL needs to improve its products and its portal in order to compete for internet advertising with companies such as Yahoo!. Since last year's Live8 concert, which millions of people watched on AOL.com, the site has had no big hits. Henry Blodget of Cherry Hill Research, a research firm, says that Time Warner's move is smart in the sense that it doesn't have much of a choice, but that the chances of success are still quite low.

That said, shareholders in Time Warner, such as Lawrence Haverty, of the Gabelli Global Multimedia Trust, an investment company, were impressed by the growth in internet advertising at AOL in the second quarter. Ad revenue leapt 40%, an acceleration from the first quarter's increase of 26%, and faster than the overall market for internet advertising, which grew by about 30%. The strong growth suggests that giving up revenue from subscribers in the hope of getting more from ads could indeed reinvigorate AOL over time.

The stakes are particularly high for the main architect of the new strategy, Jeff Bewkes, president and chief operating officer of Time Warner, and the heir-apparent to the firm's chief executive, Richard Parsons. Time Warner's share price has been falling for a while, and has declined by 9% since the firm saw off Carl Icahn, a corporate raider, in February. Fixing AOL, both agree, is the surest way to get the share price to head upwards once more.

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Pharmaceuticals

Pfizer's latest remedy

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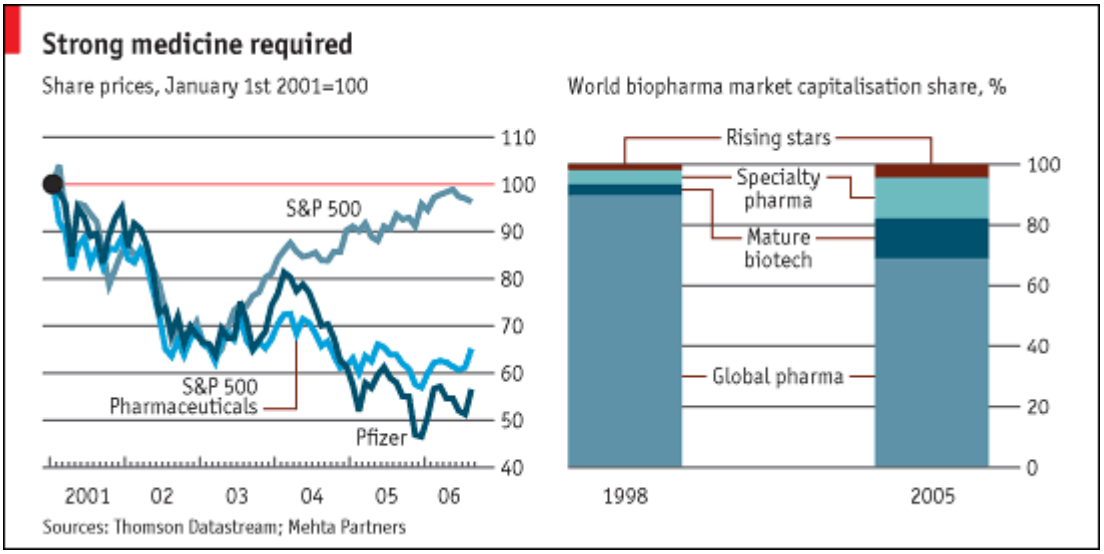
At the world's biggest drugs firm, the new boss wants action

“THE company must do business in new ways,” declared an internal memo sent this week to Pfizer's 110,000 employees. The company must, the document continued, “change in ways that are fundamental and sustained. We need to look at everything we do with fresh eyes...to make sure that we're operating nimbly and decisively.” Coming as it does from the top of the world's biggest drugs firm, one that stands accused of sclerotic self-satisfaction, the criticism and urgent tone are striking. That is just the effect desired by the memo's author, Jeffrey Kindler. He says he wants Pfizer to seize opportunities quickly—and the stinging memo appears to be his way of leading by example.

For the past few years Mr Kindler has served as Pfizer's general counsel; he previously held senior legal posts at GE and McDonald's. In order to select a successor to Henry “Hank” McKinnell, Pfizer's controversial chairman and chief executive, the board appointed Mr Kindler and two Pfizer veterans as vice-chairmen some months ago. Most observers reckoned Mr Kindler, who joined Pfizer only in January 2002, had little chance of winning the race in a company steeped in tradition. And yet that is precisely what has happened. In a stunning decision, Pfizer's board voted last week to oust Mr McKinnell ahead of schedule and install Mr Kindler in his place. The outgoing boss will retain the chairman's post for seven months, but as this week's memo made clear, there is no doubt that the new man is already in charge and raring to go.

In some ways, the recent ructions at Pfizer are a reflection of wider troubles facing big drug firms. “This is a pivotal moment for the industry,” argues Viren Mehta, an industry expert who thinks that the large pharmaceutical companies have lost their way. Since the start of the decade, Pfizer and its peers have underperformed the S&P 500 stockmarket index by around 40%. And as Mr Mehta's analysis reveals, their share of global pharmaceutical sales, and of the market capitalisation of the drugs industry, have taken a deep plunge (see chart). During that period, biotechnology firms, generics manufacturers and other, niche pharmaceutical companies have been ascendant.



That has led some analysts to argue that the drugs giants now lack agility. “There is extreme pressure to be first to market, given the rise of price pressure arising from managed care and generics,” argues John Boris of Bear Stearns, an investment bank. “Being the fifth or sixth me-too drug simply won't cut it any

more.”

With his daring acquisitions of Warner Lambert and Pharmacia, two American rivals, Mr McKinnell transformed Pfizer from an also-ran into a goliath. But the firm may now be too slow and top-heavy. Thanks to a wave of consolidation, its rivals face the same problem. Worse, lucrative drugs are coming off patent, generics are on the rise, and product pipelines are not as full as they could be.

Not everyone is so pessimistic, however. Stan Ikenberry, Pfizer's lead director, rejects the notion that the firm is adrift. “We're not fixing something that's broken. It's the industrial environment that's changing,” he says. Yet even he acknowledges the need to “de-layer” Pfizer's bureaucracy to speed up decision-making. He says the new boss's experience at McDonald's and elsewhere helped him secure the job, as the board felt “an outsider would be more open to a broad range of options.”

Emblematic as Pfizer is of the industry's woes, there is one explanation for the ousting of Mr McKinnell that is unique to the company: Mr McKinnell himself. Barbara Ryan, of Deutsche Bank, observes that he aroused “tremendous displeasure” among shareholders, and was regarded as overpaid, abrasive and aloof. “Nobody liked the closed door,” says Ms Ryan.

In his last months as chief executive, Mr McKinnell fought to keep his job. He promised investors $17 billion in share buy-backs, and raised dividends. It was too little, too late. The lesson for Mr Kindler is clear. He has won praise from analysts for his communication skills, but such applause will fade unless Pfizer's financial performance matches his grand talk.

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Face value

From online to helpline

Aug 3rd 2006
From The Economist print edition

AMSCO

Ayisi Makatiani is on a mission to promote development in Africa, one small business at a time

TEN years ago, Ayisi Makatiani would have burst out laughing if someone had suggested that he would end up working with the World Bank and the United Nations. An engineering graduate of the Massachusetts Institute of Technology, he was busy building his own business, Africa Online, which eventually became the largest pan-African internet service provider. But today Mr Makatiani uses his acumen to try to help the continent's other entrepreneurs. Since 2004, he has been at the helm of the African Management Services Company (AMSCO), based in Johannesburg. It is the brainchild of the International Finance Corporation (IFC)—the World Bank's private-sector arm—the UN Development Programme, and the African Development Bank. Its mission is to help small African firms become competitive.

It was a surprising move for an established entrepreneur. “My friends thought I was mad,” he chuckles. Ironically, his joining AMSCO was the result of a failure. For two years, he had tried to raise 300m rand ($44m) to launch Gallium, a private-equity fund for Africa. After leaving Africa Online, he wanted to use his experience to help companies in the region. But he got only half the money he wanted, and decided to drop the idea. While looking for investors, however, he had approached the IFC. They thought he was just the man to run AMSCO, and Mr Makatiani felt it was a chance to do what he had hoped to do with Gallium.

The Kenyan-born entrepreneur certainly understands the problems faced by African companies. While studying in America in the mid-1990s, he started Africa Online with two Kenyan friends. It began as a service distributing news from Africa by e-mail. “We hooked up two computers, one in Boston, the other in Kenya,” Mr Makatiani recalls. When they realised that there was demand for the service, they went on to create a web-based offering, and then rode the internet wave that was starting to sweep across the world. Africa Online was bought by Prodigy, an American technology firm. It began to provide internet access, as well as content, and expanded into other African countries, where it was often the first to offer such a service.

Setting up the company in Kenya gave Mr Makatiani a first-hand taste of some of the difficulties of doing business in Africa. Shortly after the office opened in Nairobi, powerful rivals leaned on the national

telephone operator to switch off Africa Online's phone lines, paralysing the company. Mr Makatiani was determined to stay clean, though, and stuck to a simple strategy: “if you don't pay bribes, people don't ask for them.” Appointing a well-connected board of directors helped to shield Africa Online from further troubles. A management buy-out in 1998 and the acquisition by African Lakes, an investment company, two years later led to differences over strategy, and Mr Makatiani departed.

At AMSCO, he took over a troubled ship. Created in 1989, the company was making big losses and had lost its way. “It was trying to be everything to everybody,” Mr Makatiani recalls. He cut costs, sharpened the organisation's focus and got AMSCO back into the black. It could then concentrate on promoting economic growth by giving advice to other businesses.

The local private sector is increasingly seen as having an important role to play in Africa's development. Almost half of the region's economy is informal, and there are very few small and medium-sized enterprises (SMEs) to bridge the enormous gap between informal traders and large companies. Although aid agencies have long been involved in helping businesses, fresh initiatives are now proliferating. The Investment Climate Facility, set up to improve commercial conditions in Africa, was launched in June; last year, big firms with an interest in the region started Business Action for Africa, to look at how companies can help development; and the New Partnership for Africa's Development (Nepad) also has a business initiative.

Hands-on help

AMSCO's aim is to help small firms to become competitive at home and abroad by offering management help and on-the-job training. “Harvard takes young smart people and turns them into global leaders,” explains Mr Makatiani. “We want to take SMEs and make them successful.” He believes that for many African companies, the problem is often not money or ideas, but management. AMSCO selects struggling firms that have strong potential, where experienced managers can make a big difference. It is a non-profit organisation, but its services are not free. A foundation helps clients that cannot afford its services.

AMSCO typically hires one or two specialist managers to work at the client company, usually for three years. Around 225 managers from all over the world—including Africa—are now working with 120 clients in 21 African countries. It is not easy work. The first manager placed at the Hotel Nord Sud in Mali gave up after a few months, discouraged by the task at hand—but the second turned it around. At the end of the process, the client's own management is expected to be able to fend for itself.

Global Forest Products, a South African wood company, was losing money when it approached AMSCO. Outside specialists then introduced modern wood-processing techniques, helped develop new products, improved productivity and trained their successors. Today, the company is profitable. Patricia Mothibi, Global Forest's corporate development manager, says AMSCO's specialists have transformed the company's culture. “Long after they're gone, their skills stay,” she says. At Omnium Mali, a firm that makes environmentally friendly batteries outside Bamako, the technical manager sent by AMSCO increased production by 45% and reduced the reject rate from 5% to less than 1% in a few months, by training workers and improving procedures. A small dose of management, in short, can make a difference—not just to individual firms, but more broadly. As Mr Makatiani puts it: “By making profitable companies, you develop countries.”

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Retailing in China

Ready for warfare in the aisles

Aug 3rd 2006 | HONG KONG, SHANGHAI AND SHENZHEN
From The Economist print edition

Imaginechina

For both domestic and foreign retailers, China is a market of unprecedented opportunity. But it is turning into a battleground

Get article background

TIRED after a long day helping to propel the world's most dynamic economy to new heights? Then relax under a luxury duvet, filled with the chest fluff plucked from 3,000 Icelandic wigeon, priced at a mere 110,000 yuan ($14,000) and lighter than the bag it comes in. Sam's Club in Shenzhen, China's richest city, sold its entire stock of three (only 50 are made each year) during the Chinese Spring Festival. Or choose a solid gold bottle of *baijiu* liquor for the equivalent of $11,000 or a 65-inch television for $15,000. It is not so much the high prices that are surprising, but that the Shenzhen superstore is part of America's giant Wal-Mart, which is famous for selling Western consumers cheap goods made in China.

Luxury puts the shine on Chinese retailing, although the business is mostly about selling more mundane things. Hence the Shenzhen Sam's Club also stocks gallon drums of cooking oil, plastic cups and other everyday items at rock-bottom prices. The sprinkling of expensive stuff among the bargains says much about the aspirations of modern Chinese consumers, as well as the heroic efforts of the world's retailers to win a share of their wallets. The scramble to open stores has made China a paradise for shoppers, but for shopkeepers it has become a brutally competitive market in which only the strong will survive.

Enormous numbers are luring global retailers to set up shop in China and take on a growing band of local operators. China's retail sales are set to expand by 13% to the equivalent of $860 billion this year, making the mainland the world's seventh-largest retail market. Annual compound growth rates of 8-10% will push this to an enormous $2.4 trillion by 2020.

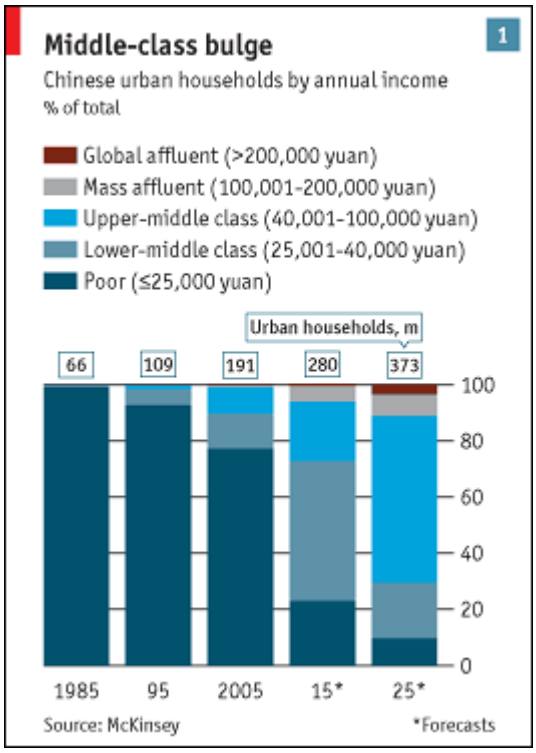
Here comes the middle class

There are more than one million affluent urban households, earning more than 100,000 yuan a year, who regularly buy luxury goods. But their spending power is rapidly being dwarfed by a vast emerging middle class. These households earn between 25,000 yuan (the threshold for becoming a serious consumer in China) and 100,000 yuan, says McKinsey. The consultancy estimates that the number of such households

will rise from 42m in 2005 to 200m by 2015 (see chart 1).

Stores like the one in Shenzhen show how much has changed in Chinese retailing. Just two decades ago, shops had surly staff offering a few drab items, often locked safely away in glass cases. Yet there is still a long way to go. Even today, much of the population buys from daily markets or directly from producers. Organised retailing remains relatively new. Most Chinese stores are tiny, family-run outfits. China's top 100 chains account for just a tenth of total retail sales.

When China's economic reforms began, state-owned department stores, such as Dalian Dashang and Wangfujing, dominated. Only in the late 1990s did specialist supermarkets and electronics and home-decor chains emerge. Yet even the largest is not national. Local protectionism raised bureaucratic hurdles to moving goods across provincial borders. Many constraints remain, says Joe Hatfield, the president of Wal-Mart Asia, who has spent 12 years working in China. With few national retailers and national brands, economies of scale are hard to achieve. Most retailers use a myriad of small suppliers operating through wholesalers. This raises costs and lowers efficiency.



Yet the arrival of foreign retailers is changing things. Apart from Wal-Mart, other successful giants have set up shop, including France's Carrefour, Britain's B&Q and Malaysia's Parkson. Foreign firms now account for 23% of the sales of the top 100 food retailers in China. More are arriving with the lifting of rules restricting foreign chains to a handful of big cities. In 2005, over 1,000 new retailers received approval, of which more than half had foreign investors. There are now over 1,000 foreign retailers in China compared with just 314 two years ago.

Local rivals have responded ferociously. Crippling price discounts can be accompanied by dirty tactics: some stores send fake “customers” to rivals' new stores to snap up all the promotions before genuine customers can get them. Another trick is to jam the doors of the lockers used by shoppers to store their purchases. Meanwhile, retailing costs are rising. As China urbanises, commercial-property prices are soaring and retailers face a doubling or tripling of rents on renewal. Marketing expenses are also growing. Between 2002 and 2004, advertising spending rose by 50% a year across all categories of consumer products in China. And wage growth is outstripping productivity gains.

Product prices, by contrast, are hardly growing. Severe overcapacity means that prices for electronic goods are declining and even food-price inflation has eased significantly. Last month, Suning, China's second-biggest home-appliance chain, announced a 25% cut in the prices of air conditioners in response to discounts offered by Gome, the market leader, and China Paradise. Store density is already high in urban China: Shanghai's Gubei district has seven hypermarkets—one for 34,000 people compared with one for 48,000 in France, where Carrefour invented the hypermarket. Yet customers can spend little. The average spend per visit in Shanghai is tiny, just 50-70 yuan ($6.30-8.80).

Michele Mak, a China retailing analyst at Credit Suisse First Boston, says these mounting pressures are already showing in the industry's 2005 financial results. Store productivity is declining, sales per square foot are falling and profit margins are shrinking. Operating margins at Gome, China's second-largest retailer by sales (see chart 2), declined from 6.2% in 2004 to 4.4% last year. Those at Lianhua Supermarket, the main grocery arm of Bailian Group, the domestic market leader, fell from 2.4% to 1.9%.

Top shop

China's top retailers, 2005

2

	Headquarters	Sales		Stores	
		yuan, bn	growth, %	number	growth in number, %
Bailian Group*	China	72.1	7	6,345	15
Gome	China	49.8	109	537	100
Suning	China	39.7	80	363	88
Vanguard	Hong Kong	32.0	26	2,133	20
Wumart	China	19.1	44	659	8
Carrefour China	France	17.4	25	73	26
China Paradise (Shanghai Yongle)	China	15.2	40	225	81
Trust-Mart	Taiwan	13.2	10	96	9
Parkson China	Malaysia	11.0	49	36	20
Lotus	Thailand	10.1	36	61	49
Wal-Mart China	US	9.9	31	60	30
B&Q China	UK	5.2	156	48	129

Source: China Chain Store and Franchise Association

*Including Lianhua

Yet the headlong expansion continues, either through the opening of yet more new stores or through a rash of takeovers. Hong Kong-listed Gome recently offered HK$5.3 billion ($680m) to buy China Paradise (also known as Shanghai Yongle), which earlier this year swallowed Beijing Dazhong. The deal will give Gome, which dominates Beijing and the north, a leading position in Shanghai and on the prosperous east coast. Its national market share in appliances will rise to more than 10%.

Gome's move is a swift reaction to the arrival in China of America's Best Buy, which in May bought Jiangsu Five Star Appliance, China's fourth-biggest appliance chain. In food, Wumart, a hypermarket operator, is taking over Beijing MerryMart. Carrefour, Wal-Mart, Tesco and Lianhua are all said to be mulling an offer for Trust-Mart, a Taiwanese-controlled chain.

However, most of the growth in Chinese retailing is coming from the opening of new outlets. Gome's head of operations, Xiangwei Weng, says his company opens a shop every 30 hours. Lianhua aims to add 500 shops across all its formats. Wal-Mart's plans for 14 more stores in the second half of this year seem modest by comparison. Carrefour wants to open 40-50 more stores in Beijing alone by 2008, from its existing eight. Parkson will triple its number of stores to almost 90 within four years.

The reason behind the rush is partly to snap up prime locations. But there is another motive. In China, suppliers can pay heavily to place their goods on retailers' shelves. They also lease space for in-store displays, help pay for promotions and give rebates. So, each time a retailer opens a new store, it can demand more payments. This means new shops can be profitable in their first year. But without working harder to improve sales at existing shops, some Chinese retailers can become highly dependent on their suppliers to finance expansion. Last year “other income” (mainly fees charged to suppliers) made up 64% of gross profit at Wumart; 45% at China Paradise; 44% at Lianhua and 31% at Gome, calculates Merrill Lynch.

Distracted by expansion, most local retailers are doing little to control costs and boost same-store sales—vital for their long-term success. But foreign retailers are providing a model for those who want to learn. At Lianhua's Century Mart hypermarket in Shanghai's wealthy Gubei district, manager Wang Yue is borrowing ideas from Carrefour's profitable hypermarket, just 2.5km (1.6 miles) down the road. Carrefour's gleaming store is huge and, with 30,000 different products, has a range that would be impressive in the West. At half its size, Ms Wang's store struggles to compete and looks empty by comparison. But things are picking up. Ms Wang has copied Carrefour's larger shopping carts and raised her spending per customer by a fifth. Carrefour's use of consumer research has also persuaded her to offer shoppers more than just low prices.

Quality, cleanliness and safety, for instance, are still rare in a country where stories abound of fake baby milk and washed diapers sold as new. Ms Wang employs 30 cleaners (10% of her staff) to counter local prejudice that Chinese-owned shops are dirtier than foreign ones. B&Q, meanwhile, tries to dispel suspicion about the low quality of Chinese-made products by letting customers touch everything it sells. Supermarkets cater to the same instinct by letting customers net their own live fish from tanks in the store.

Specialist chains are fast cashing in on middle-class preoccupations: B&Q and IKEA reflect China's growing level of home ownership and a passion for interior decorating. Parkson and Hong-Kong-owned Watson are expanding on the back of growing interest in health and beauty.

At the Shenzhen Sam's Club, 60% of the food is now imported, says Duan Lixia, the deputy manager, pointing to Chilean grapes, German chocolate and alligator meat from Australia. The store's customers can afford to own a car so there is parking for over 2,000. That helps to raise spending per customer. Car ownership in China is still low and most stores provide free shuttle buses, which limits what people can carry home. Sales per square foot at the Shenzhen store are more than double those at a typical Wal-Mart Supercentre in China. There are just three Sam's Clubs in China, but, excited by their success, Wal-Mart plans to open more.

Hong Kong-run Vanguard is experimenting with an upmarket format, Ole. Its store in Shenzhen boasts elegant wooden floors and exotic imported foods. Sales are rising by 40% a year. And China's own Lianhua is upgrading 100 dowdy supermarkets in Shanghai with great success. One in Shanghai's Xujiahui central business district outshines even Ole. It has had a 10m yuan facelift by Japanese designers and now features a juice bar, bakery, wine room and hot-food stalls. Sales are up by half and the store is packed with expatriates and *hai gui* (returnee Chinese).

Frogs and turtles

Move out of China's big cities or even into the suburbs, however, and shopping habits become more traditional as income levels fall. At a Vanguard supermarket in an unfashionable part of Shenzhen, manager Hu Fan tries to satisfy traditional and modern tastes. On the ground floor people net live fish and pick through tanks of frogs, trussed turtles and glistening chicken feet. But next to the unwrapped meat (shoppers traditionally like to handle meat to test its freshness), are plastic-covered pieces with reassuring expiry dates. Shoppers can choose from 130 types of fruit, twice the number found in a typical market.

As organised retailers move to smaller cities and further inland to escape competition and soaring rents, they face huge variations in taste and extreme price sensitivity. This complicates distribution further and raises costs. Wal-Mart's buying teams arrive in a city five months before a new store opens to research local habits: “There are thousands of uniquenesses,” says Wal-Mart's Mr Hatfield. People in Zhejiang like toilet paper “as rough as sandpaper”; the top seller in Kunming is spicy chicken feet; and Shandong natives like to buy whole steamed pigs' faces to slice up and dip in soy sauce and vinegar.

Operating profitably in poorer markets often means switching to smaller stores with a narrower range. Xu Lingling, chief financial officer at Lianhua, says that whereas big foreign players, such as Carrefour, have taken top sites in large cities, Chinese chains may be better suited to mid-sized towns where productivity is lower. And these may suit a different approach—such as the franchising of McDonald's, KFC and Tupperware, which lowers the initial level of capital investment. Avon is going further: having finally received permission to resume direct sales in February, the American cosmetics group has already recruited over 114,000 sales agents.

Nor can retailers in small cities expect the same appetite for brands as found in more cosmopolitan Shanghai or Beijing. In general, the Chinese are brand-conscious but not loyal. They are more interested in value and trying new things than Westerners are. McKinsey found Sony could charge a premium of up to 40% for televisions in developed markets, but even a 10% mark-up in China can put consumers off. And many Chinese are impulse buyers, susceptible to last-minute discounts.

One response is to shift to own label goods, which Wal-Mart is doing aggressively. Another is to move spending from general advertising to in-store promotions. In a typical Gome store, half the floorspace is dedicated to special product displays. These are manned by pushy salespeople, who are cheap to hire in China and are often paid by the manufacturer. Vanguard's supermarket in Shenzhen has 350 staff, and 500 other people promoting not just expensive electronics, but also cheap items like toothpaste and shampoo.

Stores hoping to increase loyalty are starting to promote giveaways and improve service, but often in vain. At Vanguard, buy hair dye and promoters will apply it free (customers browse its aisles sporting plastered hair and towels). Many “shoppers” happily accept freebies without spending. At the Shenzhen Wal-Mart, the buzzword is “retailtainment”. Chairs are placed around a big television so shoppers can watch football matches in air-conditioned comfort. People with empty baskets lounge on benches and

read. Upstairs, staff oversee a baby-crawling race. Zhang Hui Lan, 64, visits daily for free food tastings and to chat with staff, “who are much friendlier than in the markets.”

Yet getting people to spend more—or anything at all—is only half the task. Retailers must procure goods at the right price. In distribution and logistics, China is far behind developed countries. Strong regional tastes and lack of national scale stymie the development of national brands and efficient supply chains. Wal-Mart's 60 stores in China are served by 15,000 suppliers; its 3,800 American ones need only 61,000. Then there are the many layers of middlemen. Some foreign chains are starting to deal directly with manufacturers. Wal-Mart has introduced its notoriously hard-nosed negotiating tactics. At its Shenzhen headquarters, buyers bargain in rows of cubicles strewn with goods. Just like Wal-Mart's headquarters in Bentonville, Arkansas, the cubicles have no doors, in order to discourage the passing of bribes.

As they gain scale, big chains are also opening modern distribution centres. At the Wal-Mart centre near Shenzhen, a vast effort is under way to link suppliers electronically to the retailer's systems—only 30% have been plugged in so far, while the rest still need orders to be faxed to them. Just 20 trucks can fit in the loading bay and they can wait for more than an hour to be unloaded, largely by hand.

Wal-Mart will move to a new distribution hub in September. Its old one is outclassed by the cool efficiency of Lianhua's distribution centre in north-west Shanghai. There everything is automated and sorted on conveyor belts using barcode scanners and sophisticated lifts. Yuan Zhongmin, who runs the centre, says that with half his former workforce he can shift 60,000 cartons every ten hours, compared with 25,000 previously. The cash tied up in inventory has fallen from 100m yuan to 27m and the rate of mistakes in orders has fallen from 1% to 0.0016%.

Such improvements show how rapidly China's own retailers can catch up with the best of the foreign chains. Competition is therefore bound to get even more intense. Some retailers' profitability could suffer as they wait for the spending power of the emerging middle class to increase. But there will be handsome rewards for those that can survive this battle of hypermarket proportions.

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About sponsorship

Emerging markets and interest rates

Bernanke has it easy

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Developing countries have their own monetary headaches

SPUTTERING platinum smelters and dwindling diamond deposits do not rank highly on the list of concerns of the world's "big three" central bankers—Ben Bernanke, chairman of the Federal Reserve, Jean-Claude Trichet, president of the European Central Bank and Toshihiko Fukui, governor of the Bank of Japan. Both, however, feature in the latest inflation report of the South African Reserve Bank, which, as *The Economist* went to press, was expected to raise its benchmark interest rate by as much as half a percentage point, to 8%, having already raised it by the same amount in June.

The connection between tight monetary policy and troubled quarries and furnaces may seem a bit murky. But such is the lot of a central banker in an emerging economy, where troubles brew in remote places then break with unpredictable force. Platinum, palladium, gold and diamonds account for almost a quarter of South Africa's exports. But mining output struggled last year and shrank by about 6% in the first five months of this year. South Africa's lacklustre exports are one reason why its merchandise trade deficit was the worst on record in the first quarter and not much better in the second. The trade gap put downward pressure on the rand, which has, in turn, put upward pressure on prices. Hence the increase in interest rates.

South Africa's central bank is not alone in spreading its wings and sharpening its talons. The Czechs, Indians, Slovaks, Israelis, Hungarians and Turks all raised rates last month. Like their counterparts in Pretoria, central bankers in these countries face their own idiosyncratic challenges to price stability. In Israel, for example, the central bank wants to know how much slack remains in the job market. But how to calculate that, when the Israeli army might any day call up its reserves, which represent about 18% of the labour force?

These peculiarities aside, the central bankers share some common complaints. Their lives have all been complicated by Mr Fukui's recent triumph over deflation and Mr Bernanke's rearguard action against inflation. Thanks in part to their efforts, money is now harder to come by. Investors thus became less willing to throw it at emerging-market assets. As a result, currencies fell in May and June, stoking inflationary pressures.

Turkey's central bank has waged the fiercest fight. It has raised rates by as much in two months as the

Fed has in two years. In December 2005, it set itself the target of reducing annual inflation steadily from 7.7% to 5% by the end of this year. By June, however, annual inflation was running at over 10%. Has Turkey been overheating? The economy grew by 6.4% in the year to the first quarter, the stockmarket boomed and the current-account deficit widened. Perhaps most telling, Harvey Nichols plans to open a luxury store in Istanbul.

But the central bank lays the blame elsewhere. In an open letter, explaining the breach of its target, it bemoans higher oil, food and gold prices. Most of all it blames the lira, which fell by 23% against the dollar between May 5th and June 23rd. Were it not for this currency mischief, the bank calculates, annual inflation would have been a pardonable 8.6% in June.

The central banks of both Turkey and South Africa have promised not to allow faster inflation to persist. But so far, it seems, only South Africa's commitment is much believed. Despite the fall in the rand, South Africans expect their central bank to keep inflation within its target range of 3-6% this year and next—after all, it has done so successfully since September 2003. The weaker lira has, however, “disrupted inflation expectations” in Turkey, the central bank admitted in the minutes of its July meeting, released this week. According to its latest survey, Turks now think inflation will exceed 8% in a year, and be over 6% two years hence.

Forint or against it

As investors become pickier, keen to distinguish one emerging market from another, they may begin to see Hungary in the same light as Turkey and South Africa. It too runs a big current-account deficit, which the IMF thinks will exceed 9% of GDP this year. Indeed, on fiscal matters, the comparison is rather to Hungary's disadvantage. Turkey may labour under heavy public debts, but it is at least running a heroic budget surplus, before interest payments, estimated at 6.4% of GDP. South Africa now runs a modest fiscal deficit, but its stock of debt is quite manageable. Hungary, on the other hand, has both high debts (almost 60% of GDP in 2005) and a wide budget deficit. Nouriel Roubini, of Roubini Global Economics, calls it an “accident waiting to happen”.

Curious then, that the Hungarian forint has so far escaped the traumas visited on the rand and the lira, falling by 10.7% from peak to trough this year. Inflation remains at just 2.8% but Hungary's central bank is not taking any chances: it raised interest rates by half a percentage point on July 24th, after a quarter-point increase in June.

Mr Roubini offers three possible explanations. Perhaps the markets are complacent—but surely the turmoil of May and June woke them up? Maybe Hungary is shielded by its prospective membership of the euro—but a tie to the D-mark did not save the Italian lira or the pound sterling in the early 1990s. Or the markets may be giving the benefit of the doubt to a new government, which has unveiled plans to put public finances in order.

If so, the government impressed the markets more than the IMF, which publicly cast doubt on the wisdom and credibility of Hungary's strategy. Temporary expedients would temporarily appease the markets, the fund said, but the country would remain vulnerable.

No amount of monetary rectitude can save a country from fiscal recklessness. Indeed, hard money, which preserves the real value of domestic debts, may only serve to hasten the day of reckoning. Central bankers in emerging economies must hazard faltering exports, vengeful currency markets and political tensions. But nothing troubles a central banker more than a profligate finance minister.

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Monetary policy in the euro area

Bank on it

Aug 3rd 2006
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The European Central Bank won't stop raising interest rates yet

"PREDICTABLE" would be an understatement. In early July Jean-Claude Trichet, president of the European Central Bank (ECB), had made it pretty plain that euro-area interest rates would rise this week. He mentioned "vigilance" a lot, which markets saw as barely disguised code, and said that rather than confer by telephone, the usual August practice, rate-setters would swap swimwear for suits and gather in Frankfurt on August 3rd. Press conference to follow, in case you needed another hint. Rates duly went up by a quarter of a percentage point, to 3%. (Mr Trichet met the media after *The Economist* had gone to press.)

Quite a few economists think that the ECB, having raised rates in December, March and June, will now do so every two months rather than three, implying rates of 3.5% by December. Although the bank is unlikely to plan things so mechanically—and would be foolish to—further increases look likely and will probably be justified.

For a start, policy is still loose by any measure: after allowing for inflation, rates are no more than 0.5%. Inflation stayed at 2.5% last month, according to a first estimate published this week, well above the ECB's target of below but close to 2%.

Nor does inflationary pressure look like easing, and not just because of the risk posed by oil prices. The ECB pays far more attention to monetary developments than other central banks, seeing in fast money growth warning signs about asset prices as well as consumer-price inflation. Although credit growth slowed last month, notably for house purchases, it is still much faster than the ECB would like.

On the real side of the ledger, the euro area's GDP grew by 0.6% in the first quarter and probably managed something similar in the second. In the United States, where the economy grew by about this amount in the second quarter, this sort of pace is regarded as worryingly slow. In the euro zone, it looks unsustainably quick.

Faster growth is reflected in more buoyant labour markets. Although there are few signs yet that lower unemployment is feeding inflation, it is reaching the stage where it is worth watching (see chart). The unemployment rate across the zone fell to 7.8% in June, the lowest for nearly five years. Germany, the euro area's biggest economy, is looking much brighter—even if some of the sunshine will fade now that the World Cup is over: the jobless rate was 7.9% in June, down from 9.1% a year ago. Figures from the national labour office, which uses a different definition, suggest a further marked improvement in July.

With strong retail sales in both Germany and France, this indicates, as the ECB has said for a while, that the euro area's recovery is becoming more broadly based, shifting from exports towards domestic demand. If the American economy is slowing sharply, that is just as well.

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Hedge funds and exchanges

Joining the establishment

Aug 3rd 2006
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A bid for an American exchange highlights some complex relationships

Get article background

LOVE them or hate them, hedge funds tend to elicit strong emotions. At the same time as they are being hounded by British tabloids and American congressmen, the funds are being courted more actively than ever by financial exchanges and investment banks seeking a share of their hyperactive trading.

Thus, there is more than passing interest in the news that Man Group—one of the world's largest hedge-fund managers and biggest non-bank futures brokers—has agreed to buy control of a stumbling American futures exchange with the aim of creating new products for hedge funds. On July 27th London-based Man announced a deal with Eurex, a big German-Swiss derivatives exchange, to buy 70% of Eurex's ailing American arm for $23.2m in cash and $35m in additional capital. This Chicago exchange—formerly known as Eurex US—will now be called the US Futures Exchange (USFE). The deal should be a relief for Eurex: the Treasury and foreign-exchange futures offered by Eurex US, which tried to take on other exchanges directly, have floundered.

USFE's new chairman, Kevin Davis—a director of Man Group and chief executive of its brokerage arm, Man Financial—says the new owners intend to create specialised products for hedge funds and retail investors. There is no plan to “cannibalise” business from other futures exchanges. After all, Man is the largest trading and clearing member on most of these exchanges in America and Europe, he notes. But he also declines to say in detail what will be traded on USFE.

Hedge funds are always looking for new ways to make a profit. “There are all these funds sloshing around and not enough products to make money on,” says an executive with one big broker. But there is no guarantee they can create markets liquid enough to make exchange trading viable. Much trading by hedge funds is done bilaterally instead.

Competitors suggest that Man's longer-term strategy, despite the denials, is to gain leverage with other exchanges, threatening to pull business away if their fees get too high. There is also speculation that Man might pair its brokerage arm with the exchange for a future spin-off.

The deal comes at a time when the relationships between hedge funds, brokers and exchanges are increasingly complex. The funds, estimated to control more than $1 trillion in assets globally, are some of the most active traders in financial markets. They are also vital for brokers: a recent report from Greenwich Associates, a research firm, reckons that they account for up to half of total revenues at big equity brokers. Their share of derivatives trading is probably greater.

Yet the lines between all these parties have been blurring, particularly since the big exchanges have become publicly owned entities. The growing influence of hedge funds in this *ménage à trois* is evident in the exchanges' more ardent pursuit of them. The Chicago Mercantile Exchange has been the most eager, creating a new membership category for hedge funds and wooing them with personal attention, lower fees and input into its product design. Euronext.liffe, a London derivatives exchange, is also targeting hedge funds. Ade Cordell of Euronext.liffe says they are attractive clients not only because of their volume. “They move quicker, can make decisions and can start putting trades through immediately,” he says. No wonder they're beginning to feel loved.

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Deutsche Bank

What goes up must come down

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A rough week for Germany's biggest bank, despite buoyant results

BUYERS of bank shares should be as wary of volatile gains as they are of volatile losses; but of course they are not. Three months ago, when Deutsche Bank announced record trading profits for the first quarter, including “strong performance” in equity dealing for its own account, its share price soared. This week news that the same trading desk had booked a €100m ($126m) loss in the second quarter sent the share price racing in the opposite direction.

It was an absurd reaction, but predictable. Deutsche Bank, Germany's only global bank, attempts to make a fifth of its profits from proprietary trading. Along with its investment-banking peers on Wall Street, it probably has some of the best dealing equipment and market analysis in the world. But, as every financial adviser is supposed to caution, markets can go down as well as up. In order to make those profits in some months, almost inevitably it has to eat losses in others.

Citigroup and JPMorgan both seem to have experienced a similar trading dip because of difficult equity markets in June, with emerging markets taking the biggest toll. Since these banks follow the same markets and service the same hedge funds, it is not surprising that their performance is roughly correlated.

Deutsche Bank watchers should be more concerned, however, about the areas of the bank that are less volatile—in fact, that are hardly moving at all. These are notably its corporate advisory business and institutional fund management, two areas in which its European peers, Credit Suisse and UBS, leave it standing. Deutsche Bank's returns from its advisory business have slumped again after two better quarters. Anthony Di Iorio, the bank's new finance director, insists that this is misleading, and that the pipeline of fees for advice is full: its deal volume is rising faster than the market. But institutional assets managed by the bank have shrunk everywhere except in Germany.

In other respects, it was a bad week for Deutsche Bank. There was a report that Ralph Reynolds, the bank's head of proprietary trading in New York, was being hired by the Carlyle Group, a private-equity firm, to start a hedge fund. And in London, a court ordered the bank to pay £800,000 ($1.5m) to an ex-employee who complained of being persistently bullied in her “department from hell”.

But in Germany the bank is doing much better. It heads the league table for mergers and acquisitions, and it has put on weight in institutional and private wealth management. Its purchase of Berliner Bank in June and its visible hunt for acquisitions in mortgage and retail banking suggest that it is at least striving for a less volatile future.

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Chinese M&A

Playing at home

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Deals are booming in China, with local firms making most of the running

LIKE so much in China, mergers and acquisitions are red hot. So far this year, mainland companies have been involved in $62 billion-worth of M&A deals, almost twice as much as at this stage in 2005. Consolidation is happening in sectors from steel to supermarkets, food to finance. Until recently, the focus was on cross-border transactions, both into and out of China. But for financiers, a more promising area may well be the domestic market. There, financial reforms have encouraged companies to follow what firms elsewhere in the world are doing, partly in response to China: merging to protect profits, pricing power and market share.

To an extent, the country is being dragged along in the wake of a global boom in M&A, but financial deregulation is also helping. This month marks the first anniversary of reforms allowing companies to convert non-tradable shares (on average, still two-thirds of the total for listed Chinese companies) into ordinary shares—which can then be more easily sold to potential bidders. The reforms have led to a sharp rise in domestic share prices, boosting management confidence and prompting a flood of initial public offerings—worth 40 billion yuan ($5 billion) so far in 2006. A new rule on September 1st will allow bidders for a listed company to take control without having to buy out minorities. A proposal to allow domestic firms to finance mergers with equity and assets as well as cash is also likely to encourage M&A, if approved.

The most eye-catching deals are still the daring attempts by Chinese firms to buy overseas. State-owned oil and minerals giants, flush with cash and assured of government support, have been hunting raw materials for years. Last month China National Petroleum Corporation, the parent of PetroChina, took a $500m stake in Rosneft, the Russian oil group, having paid $4.2 billion for PetroKazakhstan, a Central Asian refiner, last year.

So far this year, Chinese companies have spent $9.3 billion on overseas acquisitions, against $2.3 billion in the same period last year. Yet, despite deep pockets, mainland firms have not had it all their own way. CNOOC, an oil producer, withdrew a $19 billion bid for Unocal, an American refiner, last year after protests in Congress. Last month China Mobile dropped its $5 billion offer for Millicom, a cellular operator. Its decision was seen by some as evidence of reluctance to overpay—welcome maturity for Chinese management, if true.

Things are no easier for foreigners in China. Lured by a huge market, foreign direct investment is running as high as $60 billion a year. Some $33 billion of that last year, and $24 billion so far this year, has been M&A. The rest has been greenfield investment. Most of the M&A has involved buying minority stakes in state firms—mainly China's banks. Goldman Sachs, UBS, Bank of America and others have spent more than $10 billion between them on holdings of less than 10% in the country's top three commercial banks.

The picture is the same even for less sensitive industries. Although China must open its markets to foreigners under World Trade Organisation rules, it is not welcoming them. Carlyle, a private-equity group, has been waiting since October for regulators to approve its $375m acquisition of Xugong, a machinery maker, although the industry is officially open to foreign investment. On July 30th, another private-equity firm, CVC Asia Pacific, saw its plans to take a 30% stake in Chenming, a leading paper mill, collapse.

Official attitudes to foreign takeovers are ambivalent. In June, Hu Jingyan, a senior commerce ministry bureaucrat, said M&A by overseas buyers would be encouraged, to boost China's competitiveness. A month later, his colleague Song Heping, deputy director of the ministry's delightfully named Industrial Damage Investigation Department, said foreign takeovers would be more closely regulated to preserve

the country's “industrial and economic integrity”. There is now a lively debate about whether assets have already been sold too cheaply to foreigners.

The least controversial area for Chinese M&A, then, is between national firms, where activity is most intense (see chart). There have already been $28 billion-worth of such deals this year. True, much of it is still state-directed and so of dubious business merit. The government plans, for example, to bang China's many steelmakers together, however sickly, to create two giant groups by the end of the decade. Overseas investors, meanwhile, are frozen out. This week's merger of Laiwu Steel with Jinan Steel is a blow to Europe's Arcelor, which wanted to buy a 38% stake in the former. Similarly, July's merger of Shanghai's Bright Dairy with three other state food groups is in part designed to stop Danone of France raising its 20% stake in Bright Dairy to a majority.

Encouragingly, though, more private companies are also recognising the need to merge: to gain scale to confront cut-throat competition at home. Gome, China's biggest home-appliance retailer, is buying rival China Paradise (see article)—in response to the entry of American rival Best Buy. Huawei and ZTE, China's leading telecoms equipment makers, are also under pressure to join forces, after a string of mergers among their global rivals. Slowly, China is turning into a more normal economy—with M&A, thanks to sensible financial-market reforms, playing its part.

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Infrastructure finance in India

Shares and shovels

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From The Economist print edition

Equity investors pitch in to help solve India's transport needs

AS ANYONE trying to get to a business meeting in India will know, the country's infrastructure makes it look anything but part of the “just-in-time” global economy. The distance from Mumbai's international airport to the heart of India's financial capital is only 30km (19 miles), but getting there can take more than two hours in the rush hour. Most of India's national highways are one lane wide, and the traffic crawls along.

Small wonder then that the government wants to overhaul the nation's roads, railways and airports, which have been pitifully starved of investment. Last year, India spent $28 billion, or 3.6% of GDP, on infrastructure. China, by comparison, spent $201 billion, or 9% of GDP, according to a report by JM Morgan Stanley, a local investment bank. Montek Singh Ahluwalia, of India's Planning Commission, told the recent annual meeting of the Asian Development Bank that India must spend an additional 2.5-3% of GDP annually on infrastructure if it is to sustain economic growth of 8-9%.

But the government, with a fiscal deficit (including the states') of about 10% of GDP, cannot hope to finance that alone. So it has sought private investors as partners. Public-private partnerships have already laid out plans to modernise the country's largest airport in Mumbai with a new terminal, runway and cargo complex. They will also provide Mumbai with its first underground railway.

So far, investors' response has been enthusiastic. Despite choppy conditions in emerging equity markets, an initial public offering by GMR Infrastructure, which has the contract to develop Delhi's airport, was fully subscribed on the first day it opened, July 31st. The issue, through which GMR aims to raise 8 billion-9.5 billion rupees ($170m-200m), was due to close on August 4th. Private-equity funds managed by Citigroup, the George Soros-promoted Quantum Fund and others had already bought close to 9% of the shares in private placements.

Investors are tempted by the juicy returns that others have made. In less than two years Chrysalis Capital, a private-equity group which counts the Harvard and Stanford university endowment trusts among its clients, saw a $9m investment in IVRCL, an infrastructure company, grow threefold and a $20m stake in Gammon India, a construction firm, increase by five times. Chrysalis has not, however, bought GMR shares because it is understood to have found the price “too rich.” Sunil Mehta, chief executive in India of American International Group, a giant insurer with money in infrastructure projects, lists many risks for private-equity investors. They include off-the-mark traffic forecasts, volatile user charges and lawsuits after acquiring large tracts of land.

Although some of the private investment takes the form of equity, debt accounts for most of the total. Most of this consists of loans from Indian public-sector banks, which are flush with cheap money. Crisil, a rating agency (and a subsidiary of Standard & Poor's) says lending by banks to infrastructure projects grew from 2% to 15.5% of their total exposure in the seven years to March 2005. A more common form of infrastructure finance is through corporate bonds, but so far this is meagre in India, with the market hobbled by delays over pension reform and hesitant steps to open the insurance sector. Moreover, foreign investment in the domestic corporate-bond market is restricted to a total ceiling of $1.5 billion. To increase private investment in infrastructure, India needs to offer investors efficient debt as well as equity markets. Meanwhile, GMR's IPO is a move, albeit along potholed roads, in the right direction.

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Economists' blogs

The invisible hand on the keyboard

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Why do economists spend valuable time blogging?

“CLEARLY there is here a problem of the division of knowledge, which is quite analogous to, and at least as important as, the problem of the division of labour,” Friedrich Hayek told the London Economic Club in 1936. What Mr Hayek could not have known about knowledge was that 70 years later weblogs, or blogs, would be pooling it into a vast, virtual conversation. That economists are typing as prolifically as anyone speaks both to the value of the medium and to the worth they put on their time.

Like millions of others, economists from circles of academia and public policy spend hours each day writing for nothing. The concept seems at odds with the notion of economists as intellectual instruments trained in the maximisation of utility or profit. Yet the demand is there: some of their blogs get thousands of visitors daily, often from people at influential institutions like the IMF and the Federal Reserve. One of the most active “econobloggers” is Brad DeLong, of the University of California, Berkeley, whose site, delong.typepad.com, features a morning-coffee videocast and an afternoon-tea audiocast in which he holds forth on a spread of topics from the Treasury to Trotsky.

So why do it? “It's a place in the intellectual influence game,” Mr DeLong replies (by e-mail, naturally). For prominent economists, that place can come with a price. Time spent on the internet could otherwise be spent on traditional publishing or collecting consulting fees. Mr DeLong caps his blogging at 90 minutes a day. His only blog revenue comes from selling advertising links to help cover the cost of his servers, which handle more than 20,000 visitors daily.

Gary Becker, a Nobel-prize winning economist, and Richard Posner, a federal circuit judge and law professor, began a joint blog in 2004. The pair, colleagues at the University of Chicago, believed that their site, becker-posner-blog.com, would permit “instantaneous pooling (and hence correction, refinement, and amplification) of the ideas and opinions, facts and images, reportage and scholarship, generated by bloggers.” The practice began as an educational tool for Greg Mankiw, a professor of economics at Harvard and a former chairman of George Bush's Council of Economic Advisers. His site, gregmankiw.blogspot.com, started as a group e-mail sent to students, with commentary on articles and new ideas. But the market for his musings grew beyond the classroom, and a blog was the solution. “It's a natural extension of my day job—to engage in intellectual discourse about economics,” Mr Mankiw says.

With professors spending so much time blogging for no payment, universities might wonder whether this detracts from their value. Although there is no evidence of a direct link between blogging and publishing productivity, a new study* by E. Han Kim and Adair Morse, of the University of Michigan, and Luigi Zingales, of the University of Chicago, shows that the internet's ability to spread knowledge beyond university classrooms has diminished the competitive edge that elite schools once held.

Top universities once benefited from having clusters of star professors. The study showed that during the 1970s, an economics professor from a random university, outside the top 25 programmes, would double his research productivity by moving to Harvard. The strong relationship between individual output and that of one's colleagues weakened in the 1980s, and vanished by the end of the 1990s.

The faster flow of information and the waning importance of location—which blogs exemplify—have made it easier for economists from any university to have access to the best brains in their field. That anyone with an internet connection can sit in on a virtual lecture from Mr DeLong means that his ideas move freely beyond the boundaries of Berkeley, creating a welfare gain for professors and the public.

Universities can also benefit in this part of the equation. Although communications technology may have

made a dent in the productivity edge of elite schools, productivity is hardly the only measure of success for a university. Prominent professors with popular blogs are good publicity, and distance in academia is not dead: the best students will still seek proximity to the best minds. When a top university hires academics, it enhances the reputations of the professors, too. That is likely to make their blogs more popular.

Self-interest lives on, as well. Not all economics bloggers toil entirely for nothing. Mr Mankiw frequently plugs his textbook. Brad Setser, of Roubini Global Economics, an economic-analysis website, is paid to spend two to three hours or so each day blogging as a part of his job. His blog, rgemonitor.com/blog/setser, often concentrates on macroeconomic topics, notably China. Each week, 3,000 people read it—more than bought his last book. “I certainly have not found a comparable way to get my ideas out. It allows me to have a voice I would not otherwise get,” Mr Setser says. Blogs have enabled economists to turn their microphones into megaphones. In this model, the value of influence is priceless.

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* “Are Elite Universities Losing Their Competitive Edge?” by E. Han Kim, Adair Morse and Luigi Zingales. NBER working paper 12245, May 2006.

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Economics focus

Least favoured nation

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Favouritism in trade cannot be stopped. Perhaps it can be broadened

MONGOLIA is a landlocked country where livestock outnumber people by 12 or more to one. It joined the World Trade Organisation (WTO) in 1997, keen, among other things, to export more cashmere and meat. But according to Damedin Tsogtbaatar, of the Mongolian Development Strategy Institute, the country has put rather more into the organisation than it has got out of it. It "chose, ironically, a rather Buddhist path of self-perfection and good WTO-consistent behaviour, without regard to whether other countries were doing the same."

If only the WTO's bigger members could say the same. Had they asked more of themselves than of their rivals, they might have saved the Doha round of trade talks, which was suspended indefinitely on July 24th. Instead, the great trading powers—America, the European Union and Japan—may now turn their energies to striking deals with individual countries or regional blocks. Hundreds of "preferential" deals of this kind already exist, all of them eroding the WTO principle of "non-discrimination" by favouring the imports of some members over others. Mongolia is now the only WTO member that has not joined one.

In a global trade round, the big players lock horns with each other, then extend their concessions to every other WTO member, even Mongolia. Outside the multilateral system, however, the biggest powers are free to pick off smaller economies one by one. Many fear this will result in a system of "hubs and spokes", in which small economies (the spokes) are drawn into agreements with big ones (the hubs), but not with each other.

This is wonderful for the rich-country hubs—they can import goods from wherever they like, even as their exporters enjoy outlying markets all to themselves. It is not so great for the spokes. By lowering tariffs on the rich countries' goods, they may trick themselves into buying from the hub, rather than from cheaper producers elsewhere. These imports arrive without paying duty, which is good for a spoke's consumers, but bad for its treasury. Indeed, the World Bank reckons a hub-and-spoke trading system would cost developing countries more than $20 billion a year.

Fortunately perhaps, the future of world trade is unlikely to conform to such a neat, radial pattern. In a new discussion paper* for the Centre for Economic Policy Research, a network of economists, Richard Baldwin argues that the trading system is much messier, and in some ways more hopeful. Today's trading blocks in America, Europe and Asia are "fuzzy" and "leaky", he says. Many of the spokes have deals with each other, and the blocks overlap. Mexico, for example, is a member of NAFTA and party to a free-trade agreement with the EU and others.

This tangle of interlocking and overlapping deals raises an interesting conceptual question. What if the forces of regionalism and bilateralism were left to play out to their logical conclusion? If every one of the WTO's 149 members were to strike a free-trade deal with every other, the world would be criss-crossed by 11,026 bilateral deals. How would this differ from multilateral liberalisation?

A bilateral or regional deal, by definition, favours one nation's goods over another's. It thus matters a great deal where an import arrives from. But a product's origins can be difficult to pin down. As a member of NAFTA, Mexico can export its overcoats to the United States duty-free. But what counts as a Mexican overcoat? What if the zip comes from Taiwan, the lining from India, or the fabric from Britain?

The genealogical rules that determine a product's country of origin are bewildering, even comical. Under NAFTA, for example, a coat is no longer Mexican if the maker imports the yarn or fabric, or sews the coat together with imported thread. American anglophiles, however, get special treatment: Mexican garments

made from Harris tweed, which is hand-woven with a loom less than 76cm wide and imported from Britain, enter duty-free.

These elaborate rules of origin also differ from agreement to agreement. Mexican garment-makers must contend with one set of regulations for America, another for the EU. Worse, the rules set off ripple effects throughout the rest of the world trading system: because America charges duty on Mexican coats made from Indian fabric, Mexico will not import fabric from India. It is as if Mexico had imposed a tariff on India, and a bilateral deal between the pair would do nothing to change that.

Flex your PECS

For the European Union, this muddle eventually became unbearable. EU firms, Mr Baldwin explains, could not necessarily import goods made by a Hungarian affiliate with Polish parts—even though Hungary and Poland each had free-trade deals with the EU and with each other. The EU's answer was the Pan-European Cumulation System, or PECS, which was introduced in 1997, and extended to Turkey in 1999. This system turned a latticework of bilateral rules into a single multilateral umbrella. Under the new arrangement, a coat that was 50% Hungarian, 30% Turkish and 20% Polish counted as 100% European.

Mr Baldwin thinks other trading blocks, East Asia's in particular, should work on their own PECS. Perhaps the WTO, an organisation suddenly left with time on its hands, could help out. “No one argues that this tangle of trade deals is the best way to organise world trade,” he writes. But no one thinks they are going away either. Only last November, for example, the Bangkok Agreement, signed in 1975 as Asia's first preferential trade agreement between developing countries, revived itself with a new name—the Asia-Pacific Trade Agreement—and a new ambition to impose some common standards on Asia's noodle soup of trade deals. Even Mongolia is interested in joining.

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* “Multilateralising Regionalism: Spaghetti Bowls as Building Blocs on the Path to Global Free Trade”. CEPR Discussion Paper No. 5775

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About sponsorship

Differences between the sexes

The mismeasure of woman

Aug 3rd 2006
From The Economist print edition

Men and women think differently. But not that differently

IN THE 1970s there was a fad for giving dolls to baby boys and fire-engines to baby girls. The idea was that differences in behaviour between the sexes were solely the result of upbringing: culture turned women into ironers, knitters and chatterboxes, and men into hammerers, drillers and silent types. Switching toys would put an end to sexual sorting. Today, it is clear why it did not. When boys and girls are born, they are already different, and they favour different toys from the beginning.

That boys and girls—and men and women—are programmed by evolution to behave differently from one another is now widely accepted. Surely, no one today would think of doing what John Money, of Johns Hopkins University, did in 1967: amputating the genitalia of a boy who had suffered a botched circumcision, and advising the parents to bring him up as a girl. The experiment didn't work, and the consequences were tragic. But which of the differences between the sexes are “biological”, in the sense that they have been honed by evolution, and which are “cultural” or “environmental” and might more easily be altered by changed circumstances, is still fiercely debated.

The sensitivity of the question was shown last year by a furore at Harvard University. Larry Summers, then Harvard's president, caused a storm when he suggested that innate ability could be an important reason why there were so few women in the top positions in mathematics, engineering and the physical sciences.

Even as a proposition for discussion, this is unacceptable to some. But biological explanations of human behaviour are making a comeback as the generation of academics that feared them as a covert way of justifying eugenics, or of thwarting Marxist utopianism, is retiring. The success of neo-Darwinism has provided an intellectual underpinning for discussion about why some differences between the sexes might be innate. And new scanning techniques have enabled researchers to examine the brain's interior while it is working, showing that male and female brains do, at one level, operate differently. The results, however, do not always support past clichés about what the differences in question actually are.

Baby blues and pinks

In the past, it was assumed that a female was simply a male with hormones, says Tracey Shors, a professor of neuroscience at Rutgers University. The truth is the exact opposite. Female is the default brain setting. Until the eighth week of gestation every human fetal brain looks female. The brain, like the rest of the human body, becomes male as a result of surges of testosterone—one during gestation and one shortly after birth.

This wash of hormones creates an organ that generates typically boyish behaviour, such as rough-and-tumble play. Behavioural differences appear early. For example, a one-day-old girl will look for longer at a face than at a mechanical mobile; a boy will prefer the mobile. That it is testosterone exposure which causes such preferences is suggested by two sorts of research. Several studies have shown that girls with a genetic disorder which exposes them to abnormally high prenatal levels of testosterone often develop boyish patterns of play. As regards boys, Simon Baron-Cohen and Svetlana Lutchmaya, two researchers at Cambridge University, found that boys exposed to relatively high levels of testosterone in the womb looked less often at their mothers' faces, made eye contact less frequently and had smaller vocabularies than those exposed to lower levels—though this study has yet to be replicated successfully by other researchers.

Within a year of birth, boys and girls also prefer different toys. Boys prefer cars, trucks, balls and guns. Girls prefer dolls and tea sets. Although evolution has clearly not had the opportunity to mould a preference for tea sets, there is evidence from another species which suggests that human infants might be predisposed to prefer toys that have particular adaptive significance to their sex. Several years ago, Melissa Hines, of City University in London, and Gerianne Alexander, of Texas A&M University, gave some vervet monkeys a selection of toys, including rag dolls, pans, balls and trucks. Male monkeys spent more time with the trucks and balls. Females played for longer with the dolls.

Obviously, cultural stereotyping is an improbable explanation for this. Nor could male monkeys have evolved a preference for fire engines. The theory put forward to explain what happened—and the similar innate preferences of human children—is that the toys preferred by young females are objects that offer opportunities for expressing nurturing behaviour, something that will be useful to them later in life. Young males, whether simian or human, prefer toys that can be used actively or propelled in space, and which afford greater opportunities for rough play.

Just behave

Differences in behaviour between the sexes must, in some way, be reflections of systematic differences between the brains of males and females. Such differences certainly exist, but drawing inferences from them is not as easy as it may appear.

For a start, men's brains are about 9% larger than those of women. That used to be cited as evidence of men's supposedly greater intelligence. Actually, the difference is largely (and probably completely) explained by the fact that men are bigger than women.

In recent years, more detailed examination has refined the picture. Female brains have a higher percentage of grey matter (the manifestation, *en bloc*, of the central bodies of nerve cells), and thus a lower percentage of white matter (the manifestation of the long, thin filaments that connect nerve cells together), than male brains. That, plus the fact that in some regions of the female brain, nerve cells are packed more densely than in men, means that the number of nerve cells in male and female brains may be similar.

Oddly, though, the main connection between the two hemispheres of the brain, which is known as the corpus callosum and is made of white matter, is proportionately smaller in men than women. This may explain why men use only one side of the brain to process some problems for which women employ both sides.

These differences in structure and wiring do not appear to have any influence on intelligence as measured by IQ tests. It does, however, seem that the sexes carry out these tests in different ways. In one example, where men and women perform equally well in a test that asks them to work out whether nonsense words rhyme, brain scanning shows that women use areas on both the right and the left sides of the brain to accomplish the task. Men, by contrast, use only areas on the left side. There is also a correlation between mathematical reasoning and temporal-lobe activity in men—but none in women. More generally, men seem to rely more on their grey matter for their IQ, whereas women rely more on their white matter.

These examples show how tricky it is to find correlations between behaviour and differences in brain structure and brain activity. And even if a connection to brain structure is found, that does not mean it is innate. Most of these studies are done on adults, so it is not clear when differences start to arise. The brain is by no means immutable, even in adulthood. In the hippocampus, an area thought to be involved in spatial learning, new nerve cells can be born in an adult and hormones influence their birth and survival. Dr Shors says that her work has shown that the female brain, at least, is very plastic, changing dramatically during life in response to pregnancy and menopause as well as puberty.

Dr Baron-Cohen suggests that innate preferences can be carried into adulthood, too. He studies autism and Asperger's syndrome, conditions that are far more common in boys than girls. His theory is that, from birth, female brains are hardwired for understanding emotions (empathising) and male brains for understanding and building systems (systemising). Hence the diverse preferences for toys. The notion is that autistic children—and autistic adults—have extremely male brains. In other words, they are especially good at systemising and especially bad at empathising.

Autism is, indeed, an extreme example. But there are thousands of studies on psychological differences between the sexes. They have looked at personality, social behaviour, memory and abilities in particular fields. For example, men are said to be more aggressive and better at mathematics, while women are more emotional and have better verbal skills.

There are a number of problems with these studies. One, according to Dr Hines, is science's bias towards reporting positive results, so that research which shows no differences is likely to get lost. Another is that because differences between the sexes are so often popularised and played up in the popular media, people tend to pay them disproportionate attention.

For example, although it is commonly held that there are reliable differences between the verbal abilities of males and females, Dr Hines suggests this is not exactly correct. She says that the results of hundreds of tests of vocabulary and reading comprehension show there is almost no gap between the sexes. Though teenage girls are better at spelling than teenage boys, the only aspect of verbal ability that is known to show a sex difference in adults is verbal fluency (the ability to produce words rapidly). For example, when asked to list as many words as possible that start with a particular letter, women usually come up with more than men. Furthermore, even when there are differences in ability between the sexes, research suggests that the scale of these differences is often smaller than people generally believe.

Storm in a d cup

In comparing differences between the sexes, researchers use a statistical measure called *d*. This indicates how far apart the averages of two groups (in this case men and women) are, taking into account the range of values that contribute to each average. The value of *d* for adult height is around 2. There is no arguing that in any given population men, on average, are taller than women. For behavioural and psychological phenomena, a value of *d* greater than 0.8 is considered large, of 0.5, moderate, and of 0.2, small. Any *d* less than 0.2 is a negligible difference.

Equipped with this statistical tool, Janet Hyde of the University of Wisconsin-Madison decided to investigate just how different men and women are. She collected all the important meta-analyses that have been conducted on differences between the sexes. (A meta-analysis combines many studies by treating the result of each as a single piece of data for statistical purposes.) Given that most of the meta-analyses she looked at addressed questions where differences were reputed to be reliable (mathematical performance, verbal ability and aggressive behaviour, in particular) she feels her results were surprising. Of the 124 effect-sizes she calculated, 30% had a value of *d* close to zero and in a further 48% of cases, *d* was small. In other words, only 22% of reported behavioural differences between the sexes are worth raising an eyebrow over.

The largest gaps were, not surprisingly, in physical attributes such as throwing velocity (d=2.14) and throwing distance (d=1.98). These closely reflect the difference in height between men and women. Another area where she found large differences was in some areas of sexuality—for example, frequency of masturbation (d=0.96) and attitudes about sex in a casual relationship (d=0.81). However, men and women reported the same degree of sexual satisfaction.

Not surprisingly, on average men were physically more aggressive (d=0.6). But in this case other work shows the danger of jumping too rapidly to a conclusion. A study done in 1994 hints that if women think nobody is watching and judging them, and there are no physical consequences, they might be more aggressive than men.

In this study, participants played a video game in which they defended themselves from attackers, and the number of bombs they chose to drop was a measure of aggression. When participants thought they were known to the experimenter and were having their performance assessed, men dropped more bombs than women did. But when those same participants were given the impression that they were anonymous, women became the more enthusiastic bombers.

Slugs and snails v sugar and spice

Differences between the sexes on a range of variables

Men better than women	d*
Mental rotation	+0.73
Physical aggression	+0.60
Mathematical problem solving†	+0.32
No significant difference	
Mathematical problem solving‡	-0.02
Vocabulary	-0.02
Reading comprehension	-0.03
Women better than men	
Smiling	-0.40
Spelling§	-0.45
Indirect aggression	-0.74 to +0.05

*d is a statistical measure of the difference between two groups. Positive values favour men, negative values women †Age 19-25 Source: Janet Hyde ‡Age 11-14 §Adolescents

Violent or not, women have as many angry thoughts as men, if not more. In a study carried out in 2004, Robin Simon, of Florida State University, and Leda Nath, of the University of Wisconsin, found no difference between the sexes in the reported frequency of incidents of feeling angry over a period of time. However, women tended to report anger that was more intense and prolonged.

A similar result on the greater intensity of female anger was reported earlier this year by Nicole Hess, of the Max Planck Institute in Berlin, and Edward Hagen, of the same city's Humboldt University. Dr Hess and Dr Hagen, however, took the matter one stage further by asking their participants what they wanted to do about it.

The researchers read the participants, who were undergraduate students, an “aggression-evoking scenario”. They were told they had just overheard a physically smaller classmate of the same sex making false and serious attacks on their reputation to a teacher. Once again, the women were angrier than the men. The real difference between the sexes, though, was in the way they proposed to retaliate. Women usually said that they would get their own back with gossip. Men were more evenly divided, with roughly half wanting to punch the slanderous classmate.

One idea to explain this is that in animals such as humans, where there is a lot of maternal care, females find physical aggression less affordable. And just because a smear is not physical does not mean that it is less damaging than a punch. Indeed, research suggests that girls find such indirect or social aggression much more hurtful than boys do.

Does it add up?

Another behavioural difference that has borne a huge amount of scrutiny is in mathematics, particularly since Dr Summers's comments. The problem with trying to argue that the male tendency to systemise suggested by Dr Baron-Cohen might lead to greater mathematical ability is that, in fact, girls and boys are equally good at maths prior to puberty. Until recently, it was believed that males outperformed females in mathematics at all ages. Today, that picture has changed, and it appears that males and females of any age are equally good at computation and at understanding mathematical concepts. However, after their mid-teens, men are better at problem solving than women are.

Males also have better spatial abilities than females. If asked to imagine rotating a three-dimensional object, a skill useful in engineering, the difference is quite large (d=0.73 and 0.56 in different studies). In this case the limited evidence available suggests the difference is related to the post-birth testosterone surge in boys. Women who were exposed to high levels of testosterone in the womb do not do noticeably better in spatial-rotation tasks.

Men do not excel in all spatial tasks, though. Again contrary to popular myth, men and women are equally good at navigating. But this is another example of a task in which the sexes take different paths to the same destination. Women tend to rely on remembering landmarks, whereas men rely on their geometric skills to work out direction and distance.

Another proposal to explain the lack of women professors of maths and science is that even if there is

little or no difference in average ability, there might be differences in the variation around this average, with more men found in the tails of the distribution curve and fewer in the middle. In other words, among males there are more idiots and more prodigies. One study of IQ, covering everyone born in Scotland in 1932, supports this idea. It showed that there were more women in the middle of the distribution, but more men at both of the extremes.

The question raised by Dr Summers does get to the heart of the matter. Over the past 50 years, women have made huge progress into academia and within it. Slowly, they have worked their way into the higher echelons of discipline after discipline. But some parts of the ivory tower have proved harder to occupy than others. The question remains, to what degree is the absence of women in science, mathematics and engineering caused by innate, immutable ability?

Innate it may well be. That does not mean it is immutable. Spatial ability is amenable to training in both sexes. And such training works. The difference between the trained and the untrained has a *d* value of 0.4, and one programme to teach spatial ability improved the retention rate of women in engineering courses from 47% to 77%. Biology may predispose, but even in the rugged world of metal bashing, it is not necessarily destiny.

A list of references is here.

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New fiction

Atonement

Aug 3rd 2006
From The Economist print edition

A master Israeli novelist asks what is left if man loses his humanity

AVRAHAM YEHOSHUA, known as “Bulli”, was 50 pages into a new novel, about an unclaimed corpse in a Jerusalem morgue, when a close friend, a peace activist named Dafna, was killed by the suicide-bomb that was detonated in a crowded cafeteria at the Hebrew University in Jerusalem in July 2002. Fourteen months later, Mr Yehoshua spoke at the funeral of two Arab waiters he had got to know well who were among 19 people killed by a lunchtime bomber at Maxim, a seashore restaurant in Haifa, his home town.

The novel Mr Yehoshua was writing, “A Woman in Jerusalem”, was virtually complete by the time the second bombing took place. The book is dedicated to Dafna, which is not surprising, for by then it had become Mr Yehoshua's *cri de coeur*: war kills people, but even the living begin to die when they lose their humanity.

Mr Yehoshua, who with Amos Oz is one of Israel's two master novelists, has long been described as the Hebrew Faulkner. Indeed, the plot of his eighth novel uses a bold and often funny improvisation on William Faulkner's 1930 classic, “As I Lay Dying”, to explore guilt, penance and public relations in Israel's underbelly.

A Woman in Jerusalem
By A.B.Yehoshua

Harcourt; 237 pages; $25.
Halban; £12.99

Buy it at
Amazon.com
Amazon.co.uk

The hero is the (unnamed) human-resources manager of a major Jerusalem company, a bakery that has flourished by victualling the Israeli army and trucking extra supplies of bread to the West Bank when times are so hard that Palestinians can afford little else and their local bakeries have been closed on suspicion of being a security risk.

When the company's 87-year-old proprietor learns that a muckraking local weekly is about to run a scathing article about a company employee, a beautiful Russian with a long swan-like neck and delicate Tartar eyes, who was killed by a suicide-bomber and whose body remains unclaimed, he directs the human-resources manager to find out what happened and to make amends, no matter what the cost. And so begins a tragi-comic saga, a sequence of ludicrous if well-meant mishaps, as the manager mounts

an improbable expedition to return the beautiful Yulia Ragayev's body to her native Soviet village.

In a subtle send-up of how very odd human beings can be, Mr Yehoshua evokes thoughts of fate, death and how people come to feel that they belong. Now almost 70, the outspoken Jerusalem-born Sephardic academic has in turn written drama, short stories and essays, as well as fiction, all exploring the spirit of Israel and what it means to be Jewish. Mr Yehoshua has never been an easy read, yet his work invites mulling over even if it resists easy definitions.

What engages Mr Yehoshua most here is the question of humanity. “You still don't realise how upsetting it is to be called inhuman. What is left to us if we lose our humanity?” Yet his evocation of what it means to be human is drawn in the subtlest strokes: an Arab cafeteria worker turns down a lift home at the end of a long night shift, preferring “to get a good night's sleep there without having to worry about the three humiliating checkpoints he had to pass through on the way back from his village every day”; the human-resources manager who has gone back to living with his mother after his divorce has a pathological aversion to double beds; forever jostled by human emotions, he is envious of the bakery workers for having to deal only with dough and machinery.

How can a nation that is so heavily militarised stop itself from becoming coarsened by violence? How can Israel keep its humanist ideals? Beneath the surface there are signs that Mr Yehoshua is deeply worried about Israel's moral future: not just in the face of war against Hizbullah, for example, but in its very own soul. Mr Yehoshua's warmest character is the old bakery owner, a man who ignores the need to sleep—he is aware enough to know there will be plenty of time to sleep once he is gone—yet who frets about doing the right thing before he dies. “I don't want to apologise,” he says when he realises the calamity of having one of his employees go missing in a morgue. “I want to do penance.”

Mr Yehoshua's “A Woman in Jerusalem” is a sad, warm, funny book about Israel and being Jewish, and one that has deep lessons to impart—for other people as well as his own.

A Woman in Jerusalem.
By A.B.Yehoshua.
Harcourt; 237 pages; $25.
Halban; £12.99

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Al-Qaeda

All about Osama

Aug 3rd 2006
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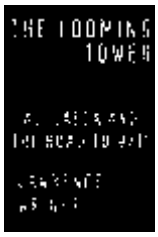
The Looming Tower: Al-Qaeda and the Road to 9/11
By Lawrence Wright



Knopf; 480 pages; $27.95.
Allen Lane; £20

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WERE it not for Osama bin Laden, an Arab eccentric with heretical religious beliefs who was little known beyond a clique of kindred fanatics, drifters, crooks and journalists, the attacks of September 11th 2001 would not have happened—and neither, perhaps, would the war on terror.

That might sound remarkable. America and a few allies have so expanded the war, to encompass the bombing of Afghanistan and the invasion of Iraq, that Mr bin Laden is no longer their prime target. There are also those who view the war as a civilisational clash between the West and the Muslim world, with Mr bin Laden a mere catalyst in it. Lawrence Wright, a writer for the *New Yorker*, will have none of this: if history changed course as the twin towers crumbled, he argues, Mr bin Laden was the single main reason why.

America had seen previous Islamist attacks. But most Islamist terrorists were parochial in their aims, attached to struggling nationalist movements in Muslim countries. The genius of Mr bin Laden—his "artistry", according to Mr Wright—was in uniting these fractious movements into an international *jihad* corps, al-Qaeda. By persuading its members to kill themselves in their attacks—a key difference from an earlier Islamist strike against the World Trade Centre, in 1993—Mr bin Laden and his lieutenants increased their effectiveness, and the group's cultish allure. If a period of conflict between the liberal and Muslim worlds had long been on the cards, Mr Wright suggests, "the charisma and vision of a few individuals shaped the nature of this contest."

The first of these was Sayyid Qutb, an Egyptian fundamentalist intellectual hanged by a military government in 1966. Qutb's ideas, including on the inevitability of a civilisational clash, gave intellectual credence to the biggest nationalist movement, the Egyptian Muslim Brotherhood. They also influenced two men who were supposedly Mr bin Laden's greatest mentors: Abdullah Azzam, a Palestinian who preached global holy war while fighting Soviet troops in Afghanistan; and Ayman al-Zawahiri, an Egyptian former member of the Brotherhood, who introduced the tactic of suicide-bombing to al-Qaeda. And then there was Mr bin Laden himself, a character too enigmatic to be easily imagined. An ascetic with a multi-million-dollar inheritance and a flair for business, a devoted father who incited mass murder, a humble student of the Koran who may be history's most successful self-publicist, he is cloaked in contradictions which Mr Wright manfully tries to unpick.

Much of the enigma, he shows, was created by Mr bin Laden himself. A typical example of his mythologising concerns his part in the Afghan *jihad*. It is well known that the American-funded holy war radicalised Mr bin Laden and a whole generation of Arab youths. According to Saudi intelligence estimates, up to 25,000 Saudis took part, and Mr bin Laden, who established the first camp for Arab fighters, was their biggest private fund-raiser. But only a small minority of these fighters actually fought, and even then badly. Mr bin Laden, who admitted to being too scared to visit the fighting on his first trips to Afghanistan, was quite typical. He achieved almost nothing on the battlefield other than a string of calamities including the massacre of 80 of his Arab fighters by pro-Soviet Afghan troops. Yet the glorious terms in which he described such mishaps recast them as victories for religious devotion and sacrifice.

Mr Wright offers not much new information on his subject—and perhaps nothing that is incontrovertible. Instead, he has sought to write the most comprehensive, objective and readable guide to al-Qaeda's emergence. He scores quite well on each count, having produced a concise history coloured by many enjoyable anecdotes. For example, we read of Mr bin Laden boasting that his prize sunflower should be in the "Guinness Book of Records", while he was living in Sudan in the early 1990s—a time when al-Qaeda

“had become largely an agricultural organisation”. But such reports should be enjoyed more than trusted: the truth is that much about Mr bin Laden is still uncertain, with creditable estimates of his wealth varying by many millions of dollars—and even of his height by up to five inches. No history of al-Qaeda can be other than a version of the truth.

Yet this is still a worthy effort to retrieve Mr bin Laden from the shadows. After all, overstretched Western intelligence agencies, which are tied up with trying to cope with many other threats in the Islamic world, seem to know little more about him than Mr Wright does. That must be most encouraging to Mr bin Laden, whose stated aim was to bring America into conflict with Muslims, along “a large-scale front which it cannot contain”.

The Looming Tower: Al-Qaeda and the Road to 9/11.
By Lawrence Wright.
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Nelson Mandela

Madiba revisited

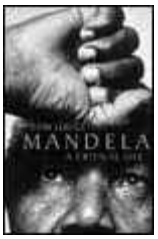
Aug 3rd 2006
From The Economist print edition

FEW birthdays, besides those of royals, dictators and Jesus, are celebrated as a national event. But every year in July, South Africans—black and white, rich and poor—unite in celebrating their favourite countryman. Now retired, Nelson Mandela, also affectionately known as Madiba, his Xhosa clan name, remains an iconic figure at home and abroad, one of the few democrats to inspire quasi-religious awe during his lifetime.

What are the sources of this appeal? This is a question that Tom Lodge, a South African professor of politics now teaching in Ireland, tries to answer in this new biography of Mr Mandela. He looks at the man and his life in an attempt to shed some light on how a mythical icon was created, and to show to what extent South Africa's first post-apartheid president himself crafted this image.

Impressive qualities clearly played a part. Mr Lodge ascribes Mr Mandela's stellar political ascendancy in the Johannesburg of the 1940s and 1950s to his patrician origins, an imposing physique, a charm and genuine empathy that won him many friends across social and racial lines, a deep attachment to chivalry, grace and honour, as well as a self-confidence rooted in his family status and his place within that family.

Mandela: A Critical Life
By Tom Lodge



Oxford University Press; 274 pages; $26 and £14.99

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But the author argues that a political context that encouraged the creation of prophetic, charismatic leaders also helped. Later, almost three decades of seclusion, during which none of his words or any photographs seeped out through his prison walls, further contributed to the creation of a mythical hero, an image that his second wife Winnie nurtured during his years in prison. Mr Mandela's sense of theatrical performance and a deep conviction of his historic destiny were also important ingredients.

Mr Lodge explains that, through his ability to bridge the modern and the traditional, the African and the Western, Mr Mandela became everything to everyone: a modern liberal democrat for European and American audiences; a radical, egalitarian freedom fighter for the African National Congress (ANC); and a messiah for many others, including white South Africans for whom “the incarnation of Mandela as a national hero has signified the possibility of personal and communal salvation or baptism in a new ‘rainbow' patriotism.”

Despite his professed taste for the African tradition of ruling by consensus, Mr Mandela has often turned to a different style of leadership, and there have been streaks of authoritarianism in his politics of unity. His decision to open negotiations with the apartheid regime went against strong opposition within the ANC, and his authority was essential in ensuring acceptance of a negotiated political transition. At times, he rebuked those expected to be supporters—from black journalists to Archbishop Desmond Tutu—for criticising the ANC publicly.

This biography reveals a complex personality, a man who learnt as a child that managing emotions was an essential attribute of adulthood. Although Mr Mandela's public persona has a self-controlled grandeur, it is possible to see through it and glimpse within the pain of his personal sacrifices and his shortcomings as a father and husband. “The political Mandela is at least in part the product of artifice,” concludes the author.

Mr Lodge's elegant biography will be essential reading for anyone wishing to look behind the myth. He has a strong feel for South Africa's history. His anecdotes are well chosen and insightful, and serve to remind the reader that Mr Mandela, although an exceptional figure, still remains all too human.

Mandela: A Critical Life.
By Tom Lodge.
Oxford University Press; 274 pages; $26 and £14.99

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Education in medieval Britain

Not what it used to be

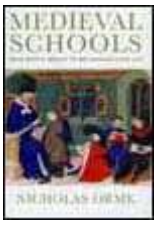
Aug 3rd 2006
From The Economist print edition

FEW children, in the developed world, spend their summer holidays bringing in the harvest. Yet the timing of the summer break dates from the days when child labour was too valuable to lose in the vital final weeks of the growing season. The roots of modern education, in Britain and elsewhere, lie in the half-hidden world of ancient schools.

Nicholas Orme's previous book, a definitive history of English medieval childhood, disproved the notion that previous generations treated children as miniature adults. This one explodes some pervasive myths about their education. First, there was quite a lot of teaching available: it was not just confined to the rich and priestly. There were hundreds of schools in England, some in monasteries and cathedrals, others founded with individual charitable endowments, often with a large bunch of private pupils paying modest fees.

Nor was education just for boys, though just how and where girls were taught is hard to trace. The boundaries between childhood and adulthood were blurred: at Winchester, the first and most generously endowed independent school, relatives of the founder could stay until they were 25.

Medieval Schools: From Roman Britain to Renaissance England
By Nicholas Orme



Yale University Press; 430 pages; $45 and £25

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Education was not just for the pious. Although biblical texts were central, there were plenty of other subjects, including maths and secular literature. Business studies—a mixture of law, accountancy and practical French—were taught at Oxford as early as the 13th century, arousing the same sniffy response from some of the dons as they do today.

Then, as now, the decline of educational standards was hotly debated. In 1509, Edmund Dudley, a counsellor to Henry VII, wrote sorrowfully, “Look well upon your two universities, how famous they have been and in what condition they be now. Where be your famous men...the good and substantial scholars of grammar?” The notion that education peaked around the time of the complainer's own graduation, and has gone down ever since, is an ancient one.

So too are some government policies. The determination to destroy good schools in the name of uniformity dates from the dissolution of the monasteries. And the state's desire to ensure that young minds are spared the danger of independent thought pops up a few years later, with the licensing of teachers and the setting of government-approved textbooks.

One weakness is the book's scope. Describing a time when national identity mattered less than it does now, some mention of schools elsewhere in Christendom would have been welcome. But provincialism in educational research is, alas, nothing new.

Medieval Schools: From Roman Britain to Renaissance England.
By Nicholas Orme.
Yale University Press; 430 pages; $45 and £25

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British royal history

Queen be

Aug 3rd 2006
From The Economist print edition

A YOUNG woman marries into the royal family and discovers that there are three people in the marriage. Neglect and separation follow. She finds consolation in the arms of a foreigner; attracts intense media attention; becomes the darling of the people, and after proceedings for divorce, dies in suspicious circumstances.

This is the story of Caroline of Brunswick who, in 1795, married the Prince of Wales, afterwards George IV. But for sheer entertainment and political theatre, it far outstrips the tale of Princess Diana. The chief characters fall straight out of their cartoons: George, a fat corseted libertine, trailing mistresses, and already secretly married to a Roman Catholic (off-limits for a future king); and his cousin, homely jolly German Caroline, sitting on the floor eating raw onions and learning the kind of English that made sailors blush.

George had chosen her sight unseen. When they met, he blanched. He managed, just, to conceive a daughter with her, then paid her off. Caroline was irrepressible. She set up her own informal court in Blackheath, took in stray children, entertained largely and scandalously, and eventually toured the Continent—a pantomime princess in rouge, pink feathers and, occasionally, men's trousers. When she fetched up in Jerusalem, she invented an Order of St Caroline and made her Italian lover, Bartolomeo Pergami, Grand Master of it.

But was Pergami her lover? That was the burning question of 1820, when George became king and faced the prospect of Caroline as queen. The only way out was divorce; the only grounds were adultery. George had had Caroline tailed for decades and every chambermaid bribed to produce evidence. Armed with this, George persuaded the Tory administration to try her by Act of Parliament.

The Trial of Queen Caroline: The Scandalous Affair that Nearly Ended a Monarchy
By Jane Robins

Free Press; 384 pages; $27.50.
Published in Britain as "Rebel Queen: The Trial of Caroline"; Simon & Schuster; £20

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But Caroline was no pushover. She fought back with her own weapon—the people. Anti-trade union laws, the suspension of *habeas corpus*, press censorship, the 1819 Peterloo massacre when 11 people were killed on St Peter's Fields in Manchester—all this had enraged them. Caroline's oppression at the hands of king and government stood for their oppression. As an individual she was negligible; as a symbol she was gunpowder.

This is the heart of Jane Robins's fascinating book. Caroline herself fades as her bandwagon gathers pace, stuffed with politicians, Whigs and Radicals, and followed by enormous crowds roaring their peculiar version of a revolutionary slogan: “No Queen, no King”. Newspaper circulations doubled, backstreet printing presses rolled off penny ballads and satires. The English, it was said, were an “inquisitive, prying, doubting, reading people” and Ms Robins brings them richly to life—especially the women who, for the first time in English history, came out collectively and publicly as a sisterhood.

The House of Lords found narrowly for the king. But they dared not face the vote in the House of Commons where George's own adulteries risked public scrutiny. The bill was dropped. Paradoxically, Caroline's victory saved the ruling class for a while. No longer a victim, her subversive appeal waned. When she died the following year, the whisper of poison led nowhere. The radicals had moved on.

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By Jane Robins.
Free Press; 384 pages; $27.50

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Orpheus Chamber Orchestra

Headless

Aug 3rd 2006 | NEW YORK
From The Economist print edition

The absence of a conductor can be a blessing, as one orchestra demonstrates

“THIS part is always screwed up with a conductor, but we've played it perfectly twice,” concludes Leon Fleisher during a recent Orpheus Chamber Orchestra rehearsal of Beethoven's “Emperor” Concerto. “This is proof that conductors should just sit down.”

Ken Nahoum/Edge Films

Non-stick people

In the dictatorial world of orchestras—where conductors choose the repertoire, organise rehearsals and tell musicians how to play—Orpheus is fond of proving that it thrives without a baton. Whereas the first violinists in other ensembles, such as the Prague and Australian chamber orchestras, are *de facto* conductors, Orpheus rotates leadership in an artistically collaborative version of musical chairs. A different core group shapes each piece and then works with the whole ensemble. Initially, this chaotic democracy resulted in inefficient rehearsals and bruised egos, but a recent rehearsal of a Bach orchestral suite suggests that it is now an efficient and civilised process, if long.

Soloists hesitate sometimes about playing with Orpheus, but then enjoy the rare chance to voice their own ideas. The orchestra does not pay huge fees, but it does require almost twice as many rehearsals, which Mr Fleisher says leads to deeper music making. “Everyone knows the standard repertory and most orchestras are wonderful sight readers. But they don't have time to get behind the notes.”

Orpheus proves that size is less important than vigour, and its string section's lush, powerful sound belies its small stature. The broad repertoire ranges from Bach to Schönberg. Despite the complex tempo fluctuations of music of the 19th century, when concertmaster-led orchestras began to be replaced by composer-conductors, Orpheus convincingly performs romantic music including Mendelssohn and Schubert symphonies, and Chopin piano concertos. Next season it even plans to perform a Schumann symphony.

“We are trying to stay true to the composer and the sound they had in mind,” says Ronnie Bauch, a violinist. For that reason, Orpheus does not play the big Mahler, Bruckner or Tchaikovsky symphonies. Orpheus musicians rely on being able to see and hear each other, and limit their ensemble to approximately 40 players.

Some conductors do not agree that their services might be dispensable. Benjamin Zander, known for his mesmerising Mahler recordings with the Philharmonia, says “the greatest and most subtle orchestral music must be guided by one mind. A collective mind is unlikely to produce the level of subtlety and

musicianship that one mind will produce.”

What Orpheus does produce are performances that are rarely humdrum, unlike all too many big-name orchestras. Playing without a conductor is risky, but the free-spirited energy of these keenly attentive musicians results in an edgy spontaneity. Eric Bartlett, a cellist with Orpheus and the New York Philharmonic Orchestra says there is a lower level of individual intensity in the latter. “If even a great conductor is empowered to make all the important decisions musicians start to play in a more passive way. Orpheus has removed a barrier between the audience and the music, the conductor himself.”

So why aren't there more conductor-less orchestras? Star conductors sell more tickets than co-operatives. And then there is the difficulty of establishing a successful collaboration between many opinionated musicians. Orpheus has begun leading workshops at the Manhattan and Juilliard schools of music, and students are learning at first hand about some of the difficulties that Orpheus has taken years to overcome. “Sometimes I'm tired and don't feel like thinking and just want someone to guide me,” says one student clarinettist. “On the other hand, conductors often aren't inspiring and just get in the way.”

Listening to a brilliant conductor leading a superb orchestra is very special. Even Orpheus members admit it can be thrilling working with energetic and inspiring maestros. But as orchestras struggle to redefine themselves, a few brave Juilliard and Manhattan students could do worse than follow the Orpheus example.

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Ta Mok

Aug 3rd 2006
From The Economist print edition

Ung Choeun ("Ta Mok"), the last surviving leader of the Khmers Rouges, died on July 21st, probably aged 80

Get article background

WHEN Ta Mok died, his body was taken to the mountain jungles of northern Cambodia. There, as the monsoon rains fell, it was laid out on a bed under a dripping porch. Incense burned; a dozen Buddhist monks kept vigil. And hundreds of villagers filed by, down the muddy road, pausing to press money into the powder-daubed, slightly bloated hands of the corpse.

It might have been a revered elder lying there, in shirt and black slacks. His name, "Ta Mok", meant "respected grandfather". Villagers mourned him because they said he had brought prosperity and work to their poor forests. He claimed the same. Under his authority, especially in the south-west of Cambodia where he had been zone secretary in the communist Khmer Rouge days, roads, dams and bridges sprang up everywhere, and bright green rice fields stretched to the horizon.

Yes, Ta Mok built dams. They were erected in the late 1960s and 1970s by thousands of slaves. These people had never done hard labour before. They were doctors, teachers, writers, scientists, forcibly evacuated from the cities with whatever they could carry, made to live in barracks and worked for 12-14 hours a day. Their food was rice, which at one point fell to 150 grams a day, or rice gruel, or watery soup of banana stalks. If they did not die of disease, starvation or exhaustion, they might be killed for reluctance or dissent, or for wearing glasses. Between executions and deaths from aggravated causes, almost a quarter of Cambodia's population—1.7m people out of 7m—died between 1975 and 1979, when the Khmers Rouges were in power.

Ta Mok denied that there was blood on his hands. Towards the end of his life, as he awaited a long-delayed trial before a UN-Cambodian court on charges of genocide, he asked his lawyer to tell the world that he had never killed anyone. Technically, this may have been true. The killings he ordered in the south-western zone were done in the deep jungle, where he never saw them. Those he master-minded for Pol Pot, the Khmer Rouge leader, when he was one of his senior advisers and later his army chief, were more like mob massacres in which no general needed to intrude. On the last forced march he organised, in 1979 as the Vietnamese were invading, he drove up and down the straggling lines of the starving in his Jeep, shouting at people to keep moving. If they dropped dead as they walked, it was not his affair. Under his rules, mourning was not allowed.

He was remembered for his shouting and cursing. Otherwise, he was unimposing: a thin, wiry, impetuous man with his party scarf flung loosely over his shoulders. Ta Mok was his *nom de guerre*, adopted almost as soon as he started fighting, as a teenager, against the French colonial power. As early as the 1950s his cruelty was notable, and noted. So was his distrust. He saw traitors everywhere, and more as the years went on. Not only his party rivals, but ordinary people too, became CIA agents, lackeys of the Thai government, agents of the Vietnamese: those neighbour-countries, especially, being threats to the Khmer Rouge regime. He made the peasants in his zone wear black clothes, the better to control them.

The falling papaya

His influence with Pol Pot sprang from long acquaintance. They were said to have met at the Buddhist Institute in Phnom Penh when, for a brief while, Ta Mok had flirted with being a monk. Monastic obedience then counted as an act of nationalist defiance, and Buddhism and communism seemed natural bedfellows. But guerrilla warfare suited both men better.

Ta Mok showed no interest in quietude or, indeed, thinking. While Pol Pot proclaimed his theories of noble agrarian equality, Ta Mok, born a peasant and with no fancy French education, talked of himself as one of the “lower brothers” at the grassroots, doing the hard revolutionary work. But he enjoyed the material rewards. He put his family—brothers, sons, daughters, in-laws—into party jobs, and built himself a fine red-brick headquarters in the middle of a lake.

In power, his basic, crude advice often cut through the jargon of the other cadres. Phnom Penh was cleared out and sacked in 1975, with the deaths of 20,000 people, largely because Ta Mok condemned his colleagues as “layabouts”. The year before, in Oudong, he had cleansed the old royal city of its 30,000 residents and burned it to the ground. The people were marched away to an uninhabited region in which they could build the new Cambodia.

After the collapse of the Khmer Rouge regime in 1979, Ta Mok kept on fighting for two decades. By the end of that time, though crippled by a landmine, he was the movement's leader. He had argued with Pol Pot, and seized power. The former leader died in 1998, in his custody, as both men fled farther into the northern mountains. Ta Mok, himself about to be arrested, summed up his comrade's death with a peasant's brutality. Pol Pot had fallen “like a ripe papaya” and was now no more than “cow shit”. In fact, he added, he was less than that. Cow shit was useful.

Ta Mok's own grave, close to Pol Pot's in the grounds of a forest pagoda, visited respectfully by villagers bearing incense sticks, might bear the same epitaph.

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Overview

Aug 3rd 2006
From The Economist print edition

America's GDP grew at an annual rate of 2.5% in the second quarter, down from 5.6% in the first. The Federal Reserve's preferred measure of inflation—the price index for core personal consumption expenditures—rose by 2.4% in the year to June, too fast for comfort. There was better news in the Institute for Supply Management's index of manufacturing, which gave a reading of 54.7 in July, up from 53.8 the month before. And despite a weakening housing market, construction spending grew by 0.3% in June thanks to strong non-residential building.

Industrial production in **Japan** increased by 1.9% in June, surpassing expectations. Output was 4.8% higher than a year before. The average price of a square metre of land rose by 0.9% from a year earlier. In Tokyo it went up by 5.4%.

In the **euro area**, annual consumer-price inflation remained at 2.5% in July, according to first estimates. Unemployment fell to 7.8% in June, seasonally adjusted, from 7.9% in May. In **Germany,** unemployment fell to 10.6%, also seasonally adjusted, on the federal labour office's measure, the lowest rate in almost two years.

Australia's central bank raised interest rates by a quarter of a percentage point to 6%, a 5½-year high. This was its second increase in four months. Annual inflation was 4% in the second quarter, pushed up by higher prices for petrol and fruit.

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Output, demand and jobs

Aug 3rd 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2006	2007	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.1	Q1	+ 3.5	+ 3.2	+ 3.4	– 1.0	Q1	+ 3.6	Q2	4.9	Jun	5.0
Austria	+ 3.0	Q1	+ 2.4	+ 2.2	+ 1.9	+ 6.2	May	+ 3.6	May	4.8	Jul	5.2
Belgium	+ 2.8	Q2	+ 3.2	+ 2.4	+ 1.9	+ 7.6	May	+ 2.6	May	12.0	Jun†	12.3
Britain	+ 2.6	Q2	+ 3.4	+ 2.4	+ 2.5	– 0.7	May	+ 3.6	Jun	5.4	May‡	4.7
Canada	+ 3.2	Q1	+ 3.8	+ 3.2	+ 2.7	– 0.4	May	+ 5.7	Apr	6.1	Jun	6.8
Denmark	+ 3.5	Q1	+ 0.8	+ 2.7	+ 2.2	+ 6.1	May	+ 3.6	Jun	4.5	Jun	5.8
France	+ 1.5	Q1	+ 2.1	+ 2.1	+ 1.9	+ 2.7	May	+ 1.4	May	9.0	Jun	10.0
Germany	+ 1.4	Q1	+ 1.6	+ 1.8	+ 1.2	+ 6.0	May	– 0.4	Jun	10.6	Jul§	11.8
Italy	+ 1.5	Q1	+ 2.4	+ 1.3	+ 1.1	+ 2.9	May	+ 1.5	Apr	7.4	Q1	7.8
Japan	+ 3.8	Q1	+ 3.1	+ 3.0	+ 2.4	+ 4.8	Jun	– 0.3	May	4.2	Jun	4.2
Netherlands	+ 2.9	Q1	+ 0.7	+ 2.3	+ 2.1	+ 1.8	May	+ 8.0	Apr	5.5	Jun††	6.7
Spain	+ 3.5	Q1	+ 3.3	+ 3.3	+ 2.8	+ 7.9	May	+ 1.3	May	8.3	Jun	9.3
Sweden	+ 4.1	Q1	+ 4.6	+ 3.7	+ 2.8	+ 6.3	May	+ 7.4	Jun	6.3	Jun†	7.1
Switzerland	+ 3.5	Q1	+ 3.8	+ 2.9	+ 1.9	+ 9.2	Q1	+ 5.9	May	3.1	Jun†	3.6
United States	+ 3.5	Q2	+ 2.5	+ 3.4	+ 2.7	+ 4.5	Jun	+ 3.4	Jun	4.6	Jun	5.0
Euro area	+ 1.9	Q1	+ 2.4	+ 2.2	+ 1.8	+ 4.9	May	+ 0.8	May	7.8	Jun	8.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.8	Q1	+ 1.6	na	na	+22.3	Jun	+ 5.3	May	7.7	Jun	8.2
Greece	+ 4.1	Q1	na	na	na	+ 0.6	May	+ 9.8	Apr	9.7	Q1†	10.4
Iceland	+ 5.0	Q1	na	na	na	na		na		1.3	May†	2.2
Ireland	+ 5.8	Q1	+ 4.4	na	na	+ 6.9	May	+ 4.4	May	4.5	Jun	4.3
Luxembourg	+ 7.3	Q1	na	na	na	– 1.4	May	+ 4.6	May	4.0	Jun†	3.9
New Zealand	+ 2.1	Q1	+ 2.3	na	na	– 0.7	Q1	+ 3.0	Q1	3.9	Q1	3.9
Norway	+ 5.4	Q1	+ 2.3	na	na	– 5.2	May	+ 6.3	May	3.7	May**	4.7
Portugal	+ 1.0	Q1	+ 1.8	na	na	+ 1.7	Jun	– 4.9	Jun	7.7	Q1†	7.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Mar-May; claimant count rate 3.0% in Jun. §EU harmonised rate 8.2% in Jun. ††Apr-Jun. **Mar-May.

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Prices and wages

Aug 3rd 2006
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 4.0	Q2	+ 2.5	+ 2.9	+ 2.7	+ 9.9	Q2	+ 6.9	+ 4.0	Q1	+ 4.5
Austria	+ 1.5	Jun	+ 2.3	+ 2.0	+ 1.9	+ 3.9	Jun	+ 0.7	+ 2.8	Jun	+ 2.2
Belgium	+ 1.6	Jul	+ 3.1	+ 2.1	+ 1.9	+ 6.1	Jun	+ 2.4	+ 2.3	Apr	+ 2.6
Britain	+ 2.5	Jun*	+ 2.0	+ 2.0	+ 1.9	+ 3.3	Jun	+ 2.5	+ 4.1	May†	+ 4.1
Canada	+ 2.5	Jun	+ 1.7	+ 2.3	+ 2.1	+ 2.2	Jun	+ 0.1	+ 0.3	May	+ 1.0
Denmark	+ 2.2	Jun	+ 1.8	+ 2.0	+ 2.0	+ 4.6	Jun	+ 3.9	+ 2.9	Q1	+ 3.1
France	+ 1.9	Jun	+ 1.7	+ 1.9	+ 1.6	+ 3.9	Jun	+ 2.9	+ 3.3	Q1	+ 2.9
Germany	+ 1.9	Jul	+ 2.0	+ 1.8	+ 2.3	+ 5.3	Jun	+ 2.2	+ 1.1	May	+ 0.6
Italy	+ 2.2	Jul	+ 2.1	+ 2.1	+ 1.9	+ 6.2	Jun	+ 3.7	+ 2.9	Jun	+ 3.0
Japan	+ 1.0	Jun	– 0.5	+ 0.5	+ 0.6	+ 3.3	Jun	+ 1.4	+ 1.1	Jun	+ 0.5
Netherlands	+ 1.3	Jul	+ 1.6	+ 1.5	+ 1.5	+ 5.8	Jun	+ 5.0	+ 1.9	Jun	+ 0.6
Spain	+ 3.9	Jun	+ 3.2	+ 3.6	+ 2.9	+ 6.3	Jun	+ 4.4	+ 3.0	Q1	+ 2.5
Sweden	+ 1.5	Jun	+ 0.6	+ 1.4	+ 1.8	+ 4.4	Jun	+ 3.2	+ 3.2	May	+ 1.6
Switzerland	+ 1.4	Jul	+ 1.2	+ 1.3	+ 1.2	+ 3.1	Jun	+ 0.5	+ 1.0	2005	+ 0.9
United States	+ 4.3	Jun	+ 2.5	+ 3.5	+ 2.4	+ 4.9	Jun	+ 3.7	+ 3.9	Jun	+ 2.7
Euro area	+ 2.5	Jul	+ 2.2	+ 2.2	+ 2.1	+ 5.8	Jun	+ 4.0	+ 2.2	Q1	+ 3.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.7	Jun	+ 1.1	na	na	+ 5.6	Jun	+ 4.0	+ 3.4	Q1	+ 4.0
Greece	+ 3.2	Jun	+ 3.3	na	na	+ 7.2	Jun	+ 5.0	na		na
Iceland	+ 8.4	Jul	+ 3.5	na	na	+11.8	Jul	+ 3.7	+ 8.8	Jun	+ 6.3
Ireland	+ 3.9	Jun	+ 2.1	na	na	– 0.4	Jun	– 0.3	+ 2.2	Q1	+ 6.4
Luxembourg	+ 3.2	Jun	+ 2.2	na	na	+ 7.4	May	+ 7.9	+ 2.2	Apr	+ 1.0
New Zealand	+ 4.0	Q2	+ 2.8	na	na	+ 7.2	Q1	+ 4.2	+ 3.3	Q1	+ 2.5
Norway	+ 2.1	Jun	+ 1.7	na	na	+13.2	Jun	+19.3	+ 3.6	Q1	+ 4.2
Portugal	+ 2.9	Jun	+ 1.6	na	na	+ 6.0	Jun	+ 3.5	+ 1.5	May	– 3.3

*RPI inflation rate 3.3% in Jun. †Mar-May.

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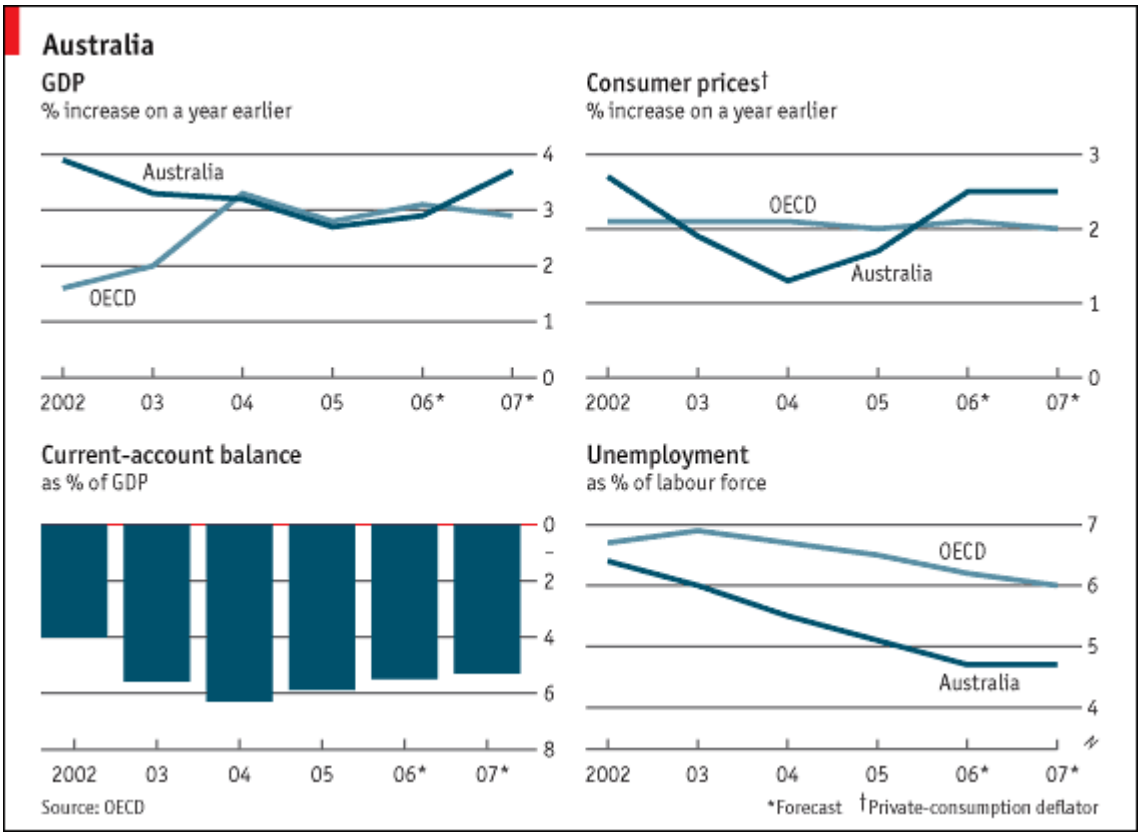
Australia

Aug 3rd 2006
From The Economist print edition



Australia has hit its stride, according to the OECD's latest survey of the country. Six years of solid economic growth, unemployment at a 30-year low, and a government with no net debts to speak of make the country a model of stability. The OECD praises Australia for “making its own luck”, but warns it against macroeconomic complacency. The country may be enjoying record prices for its commodities, but a similar boom three decades ago thrust Australia into chaos. The country must continue to combat creeping inflation and sustain its living standards as its population ages. It could also improve public-sector efficiency by ensuring that the central government and the states know their roles. Its labour market could work better. Although wages have risen and unemployment has dropped, many workers are still caught in “low-wage traps”, the survey says.

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Money and interest rates

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	Money supply* % change on year ago			Interest rates % p.a. (Aug 2nd 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+10.2	+ 9.6	Jun	6.19	5.65	5.94	5.84	5.30	6.96
Britain	+ 5.7‡	+13.7	Jun	4.73	4.56	4.75	4.64	4.37	5.71‡
Canada	+12.3	+ 6.4	Jun	4.15	2.60	4.13	4.34	3.98	5.60
Denmark	+13.2	+10.0	Jun	3.25	2.20	3.61	3.93	3.27	5.25
Japan	+ 4.0	+ 1.2	Jun	0.34	0.02	0.82	1.91	1.37	2.10
Sweden	+ 0.2	+10.5	Jun	2.25	1.45	3.20	3.81	3.17	3.87
Switzerland	– 0.9	+ 1.4	Jun	1.55	0.76	1.85	2.68	2.02	2.72
United States	– 0.1	+ 4.8	Jun§	5.32	3.54	4.94	4.96	4.30	5.95
Euro area†	+ 9.3	+ 8.5	Jun	3.18	2.13	3.48	3.89	3.29	4.47

*Narrow: M1 except Britain notes and coin and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡New series. §New series for broad money supply. Benchmarks: US 30-year 5.06%, Japan No. 280 1.90%. Central bank rates: US fed funds 5.25%, ECB refinancing 2.75%, BOJ overnight call 0.25%, BOE repo 4.5%. Sources:Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Aug 3rd 2006
From The Economist print edition

2000=100

	Jul 25th	Aug 1st*	% change on one month	% change on one year
Dollar index				
All items	173.5	175.8	nil	+ 28.5
Food	136.8	136.8	– 2.1	+ 5.1
Industrials				
All	220.9	226.3	+ 1.7	+ 55.6
Nfa†	154.2	154.0	– 4.6	+ 14.1
Metals	257.3	265.6	+ 3.9	+ 75.8
Sterling index				
All items	142.4	142.8	– 1.1	+ 21.8
Euro index				
All items	127.1	127.6	+ 0.5	+ 23.1
Yen index				
All items	188.1	187.9	+ 0.5	+ 32.9
Gold				
$ per oz	610.95	639.65	+ 2.4	+ 47.8
West Texas Intermediate				
$ per barrel	73.75	75.03	+ 3.0	+ 21.2

*Provisional. †Non-food agriculturals.

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Stockmarkets

Aug 3rd 2006
From The Economist print edition

Market indices

	Aug 2nd	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	4,906.6	5,318.2	4,708.8	nil	– 7.7	+ 4.2	+ 8.7
Austria (ATX)	3,739.5	4,344.4	3,324.1	+ 1.1	–14.9	+ 0.8	+ 9.5
Belgium (Bel 20)	3,807.9	3,987.3	3,445.1	+ 2.3	– 6.6	+ 4.9	+13.9
Britain (FTSE 100)	5,932.1	6,132.7	5,506.8	+ 0.9	–15.2	+ 4.6	+14.4
Canada (Toronto Composite)	11,969.9	12,487.3	10,904.3	+ 0.8	– 4.9	+ 5.4	+ 9.4
Denmark (OMXCB)	356.5	395.5	325.0	+ 2.6	–12.1	– 5.5	+ 2.6
France (SBF 250)	3,531.2	3,755.6	3,244.2	+ 1.5	–20.8	+ 5.4	+14.4
France (CAC 40)	5,026.3	5,312.2	4,615.4	+ 1.7	–28.6	+ 4.8	+13.9
Germany (DAX)*	5,680.8	6,140.7	5,292.1	+ 1.8	–30.8	+ 3.2	+12.1
Italy (S&P/MIB)	36,738.0	38,765.0	34,850.0	+ 1.5	–27.7	+ 1.4	+10.1
Japan (Nikkei 225)	15,464.3	17,563.4	14,218.6	+ 3.9	–61.8	– 7.6	– 4.8
Japan (Topix)	1,569.7	1,783.7	1,458.3	+ 3.2	–47.3	– 7.8	– 5.1
Netherlands (AEX)	455.3	478.0	412.9	+ 2.0	–36.4	+ 2.2	+11.0
Spain (Madrid SE)	1,288.5	1,318.5	1,156.8	+ 2.0	– 4.2	+ 9.2	+18.6
Sweden (Affarsvarlden Gen)	295.3	333.7	275.2	+ 0.4	–26.5	+ 0.2	+11.2
Switzerland (Swiss Market)	7,905.2	8,122.1	7,154.9	+ 1.2	– 7.1	+ 3.0	+10.6
United States (DJIA)	11,199.9	11,642.7	10,667.4	+ 0.9	– 5.3	+ 3.6	+ 3.6
United States (S&P 500)	1,278.6	1,325.8	1,223.7	+ 0.8	–17.0	+ 1.6	+ 1.6
United States (NASDAQ Comp)	2,078.8	2,370.9	2,020.4	+ 0.4	–59.0	– 6.1	– 6.1
Europe (FTSEurofirst 300)†	1,341.2	1,405.6	1,238.7	+ 1.5	–22.5	+ 3.5	+12.5
Euro area (FTSE Euro 100)†	1,136.9	1,198.7	1,050.0	+ 1.8	–28.0	+ 2.5	+11.4
World (MSCI)‡	1,330.7	1,406.3	1,243.9	+ 2.0	–10.0	+ 3.7	+ 3.7
World bond market (Citigroup)††	643.8	648.4	612.1	+ 1.6	– 5.0	+ 2.1	+ 2.1

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Aug 3rd 2006
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	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Aug 2nd	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Aug 2nd	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2006‡
Australia	− 12.7 May	− 40.6 Q1	− 5.6	− 5.2	118.5	119.2	1.31	1.30	2.45	1.67	1.14	+ 0.9
Austria	− 1.3 May	+ 0.5 Dec	+ 0.3	− 0.1	105.6§	105.4	0.78	0.81	1.47	–	0.68	− 1.9
Belgium	+ 13.1 May	+ 7.3 Mar	+ 1.5	+ 1.6	107.4§	107.2	0.78	0.81	1.47	–	0.68	− 0.4
Britain	−128.1 May	− 52.3 Q1	− 2.9	− 2.9	101.0	98.0	0.53	0.56	–	0.68	0.46	− 3.4
Canada	+ 59.9 May	+ 31.8 Q1	+ 2.1	+ 1.1	127.9	119.1	1.13	1.21	2.11	1.44	0.98	+ 2.2
Denmark	+ 8.5 May	+ 5.1 May	+ 2.3	+ 2.2	106.3	106.1	5.82	6.06	10.9	7.46	5.08	+ 3.3
France	− 31.7 May	− 33.4 May	− 1.8	− 1.5	108.3§	108.0	0.78	0.81	1.47	–	0.68	− 2.9
Germany	+189.9 May	+108.1 May	+ 3.7	+ 3.8	109.9§	109.5	0.78	0.81	1.47	–	0.68	− 3.1
Italy	− 19.9 May	− 30.3 May	− 1.6	− 1.5	107.9§	107.6	0.78	0.81	1.47	–	0.68	− 4.2
Japan	+ 80.6 May	+165.8 May	+ 3.8	+ 3.8	81.6	85.8	115	111	215	147	–	− 5.2
Netherlands	+ 38.6 May	+ 42.3 Q1	+ 5.9	+ 5.8	108.3§	108.0	0.78	0.81	1.47	–	0.68	− 0.5
Spain	−101.4 May	− 91.2 Apr	− 7.7	− 7.7	105.8§	105.6	0.78	0.81	1.47	–	0.68	+ 1.1
Sweden	+ 19.6 Jun	+ 23.2 Q1	+ 6.6	+ 6.1	98.6	95.8	7.18	7.62	13.5	9.19	6.26	+ 1.7
Switzerland	+ 7.2 Jun	+ 51.7 Q1	+13.4	+12.5	106.0	106.3	1.23	1.26	2.31	1.57	1.07	− 0.2
United States	−822.8 May	−808.5 Q1	− 6.8	− 6.9	83.0	85.4	–	–	1.88	1.28	0.87	− 3.6
Euro area	− 5.1 May	− 56.9 May	− 0.4	− 0.3	118.8	117.0	0.78	0.81	1.47	–	0.68	− 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 7.1 May	+ 10.1 May	na	na	109.0§	108.8	0.78	0.81	1.47	–	0.68	+ 2.2
Greece	− 36.8 Apr	− 23.3 May	na	na	104.8§	104.6	0.78	0.81	1.47	–	0.68	− 3.0
Iceland	− 1.9 Jun	− 3.1 Q1	na	na	94.0**	104.5	71.2	63.5	134	91.2	62.1	+ 2.0
Ireland	+ 38.0 May	− 5.6 Q1	na	na	113.7§	113.3	0.78	0.81	1.47	–	0.68	− 0.3
Luxembourg	− 5.0 May	+ 3.9 Q1	na	na	107.4§	107.2	0.78	0.81	1.47	–	0.68	− 1.7
New Zealand	− 4.6 Jun	− 10.1 Q1	na	na	120.6	134.9	1.61	1.45	3.02	2.06	1.41	+ 4.6
Norway	+ 57.6 Jun	+ 50.2 Q1	na	na	111.5	111.9	6.15	6.37	11.6	7.88	5.37	+ 18.5
Portugal	− 23.9 Apr	− 16.8 May	na	na	105.6**	106.4	0.78	0.81	1.47	–	0.68	− 5.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, May average. ‡OECD forecast. **IMF, March average.

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Trade

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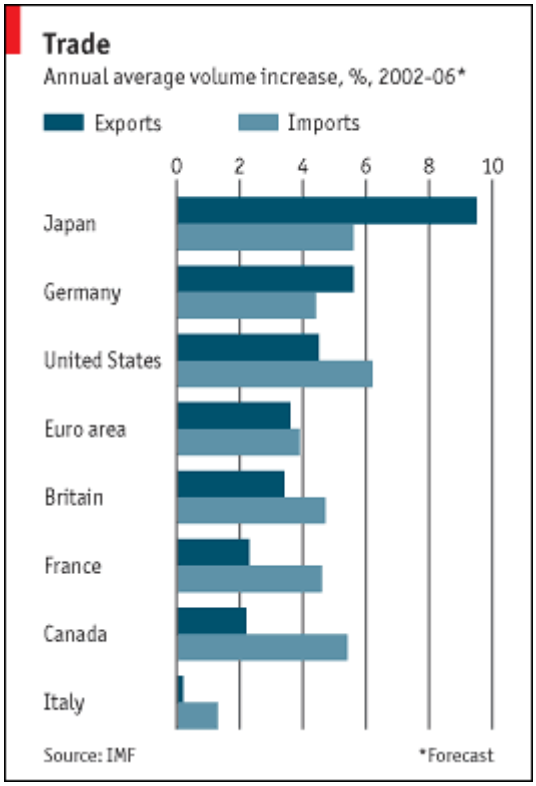

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Overview

Aug 3rd 2006
From The Economist print edition

Industrial production expanded by 10.9% in **South Korea**, 6.1% in **Thailand** and 2.3% in **Chile** in the year to June. In the **Philippines** and **Indonesia**, however, industrial production contracted by 5.4% and 1.6% respectively in the year to May.

In **India**, annual inflation was 7.7% in the year to June, much faster than the 6.3% recorded in May. In **Indonesia**, consumer prices rose by 15.2% in the year to July.

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Exports

Aug 3rd 2006
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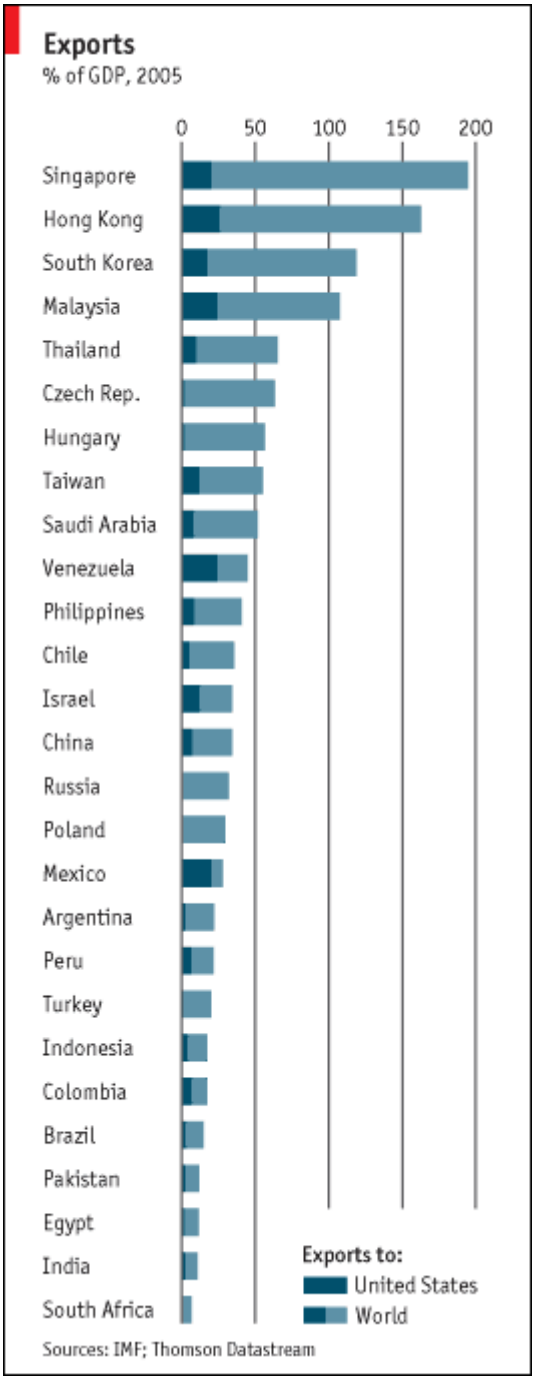
Singapore is the epitome of an entrepôt economy: it exported goods worth nearly 200% of its GDP in 2005. How did it manage this? By importing goods worth almost as much. Exports also accounted for more than 100% of GDP in Hong Kong, South Korea and Malaysia. Of the Europeans, the Czech Republic and Hungary are the most dependent on foreign markets, with exports accounting for more than 50% of GDP.



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Economy

Aug 3rd 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+11.3	Q2	+19.5	Jun	+ 1.5	Jun	+123.0	Jun	+160.8	2005	941.1	Jun
Hong Kong	+ 8.2	Q1	+ 7.0	Q1	+ 2.2	Jun	−14.0	Jun	+20.7	Q1	126.6	Jun
India	+ 9.3	Q1	+10.0	May	+ 7.7	Jun	−51.2	Jun	−10.6	Q1	156.0	Jun
Indonesia	+ 4.6	Q1	− 1.6	May	+15.2	Jul	+33.5	Jun	+ 3.8	Q1	42.3	May
Malaysia	+ 5.3	Q1	+ 5.5	May	+ 3.9	Jun	+26.9	May	+19.5	Q1	78.5	Jun
Pakistan	+ 6.6	2006†	+11.6	Mar§	+ 7.7	Jun	−12.0	Jun	− 4.8	Q1	11.4	May
Philippines	+ 5.5	Q1	− 5.4	May	+ 6.7	Jun	− 3.9	May	+ 2.9	Mar	18.2	Jun
Singapore	+ 7.5	Q2	+22.5	Jun	+ 1.4	Jun	+33.4	Jun	+36.1	Q1	128.7	Jun
South Korea	+ 5.3	Q2	+10.9	Jun	+ 2.3	Jul	+17.0	Jul	+ 7.8	Jun	225.7	Jul
Taiwan	+ 4.9	Q1	+ 5.5	Jun	+ 1.7	Jun	+10.7	Jun	+18.1	Q1	260.4	Jun
Thailand	+ 6.0	Q1	+ 6.1	Jun	+ 4.4	Jul	− 2.4	Jun	+ 2.7	Jun	56.4	Jun
Argentina	+ 8.6	Q1	+ 8.9	Jun	+11.0	Jun	+11.8	Jun	+ 6.7	Q1	24.4	Jun
Brazil	+ 3.4	Q1	+ 4.8	May	+ 4.0	Jun	+45.3	Jul	+12.1	Jun	62.7	Jun
Chile	+ 5.1	Q1	+ 2.3	Jun	+ 3.9	Jun	+15.0	Jun	+ 0.8	Q1	17.6	Jun
Colombia	+ 5.2	Q1	+12.0	May	+ 4.3	Jul	+ 1.1	Apr	− 2.0	Q1	14.3	Jun
Mexico	+ 5.5	Q1	+ 5.7	May	+ 3.2	Jun	− 4.2	Jun	− 1.2	Q1	81.4	May
Peru	+ 6.5	May	+ 2.7	May	+ 1.5	Jul	+ 6.0	May	+ 0.7	Q1	13.3	May
Venezuela	+ 9.4	Q1	− 8.0	Apr	+13.5	Jul	+34.8	Q1	+28.1	Q1	22.3	May
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 6.4	Jun	−11.2	Q1	+ 2.1	Q1	21.8	Jun
Israel	+ 5.2	Q1	+10.4	May	+ 3.5	Jun	− 8.0	Jun	+ 4.4	Q1	27.5	Jun
Saudi Arabia	+ 6.6	2005‡	na		+ 2.2	May	+126.5	2005	+90.7	2005	27.2	May
South Africa	+ 4.0	Q1	+ 5.1	May	+ 4.9	Jun	− 6.9	Jun	−11.7	Q1	21.5	Jun
Czech Republic	+ 7.4	Q1	+12.2	May	+ 2.8	Jun	+ 1.5	May	− 3.4	Q1	30.4	Jun
Hungary	+ 4.6	Q1	+ 7.4	May	+ 2.8	Jun	− 3.1	May	− 7.9	Q1	21.1	Jun
Poland	+ 5.2	Q1	+12.4	Jun	+ 0.8	Jun	− 2.6	May	− 4.2	May	44.9	Jun
Russia	+ 5.5	Q1	+ 2.9	Jun	+ 9.1	Jun	+136.0	May	+91.4	Q2	243.2	Jun
Turkey	+ 6.4	Q1	+ 9.0	May	+10.1	Jun	−49.4	Jun	−28.7	May	56.8	Jun
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+11.7	Q1	+ 6.3	Jun	+ 4.3	Jun	− 2.7	May	− 1.8	May	2.1	May
Latvia	+13.5	Q1	+ 2.3	May	+ 6.3	Jun	− 3.5	May	− 2.3	May	3.1	May
Lithuania	+ 7.7	Q2	na		+ 3.7	Jun	− 3.9	May	− 2.1	May	4.2	May
Slovakia	+ 6.3	Q1	+11.4	May	+ 4.6	Jun	− 2.9	May	− 4.7	Apr	16.6	May
Slovenia	+ 5.1	Q1	+ 9.8	May	+ 2.0	Jul	− 1.7	May	− 0.3	May	8.4	Apr

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate. §New series.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Aug 3rd 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Aug 2nd		Dec 30th 2005	
	Aug 2nd	year ago	Aug 2nd	% a year		one week	in local currency	in $ terms
China	7.97	8.11	15.0	3.20	1,682.8	– 5.1	+ 37.8	+ 39.5
Hong Kong	7.77	7.77	14.6	4.31	17,032.8	+ 2.5	+ 14.5	+ 14.2
India	46.7	43.4	87.7	6.42	10,876.2	+ 2.4	+ 15.7	+ 11.5
Indonesia	9,110	9,755	17,111	12.69	1,394.4	+ 6.2	+ 19.9	+ 29.5
Malaysia	3.68	3.75	6.90	3.90	934.1	nil	+ 3.8	+ 6.7
Pakistan	60.3	59.6	113	10.37	10,558.3	+ 2.1	+ 10.5	+ 9.6
Philippines	51.6	56.1	97.0	7.38	2,308.3	+ 0.8	+ 10.1	+ 13.1
Singapore	1.58	1.65	2.97	3.56	2,454.0	+ 2.0	+ 4.5	+ 10.0
South Korea	962	1,018	1,807	4.63	1,295.1	+ 1.3	– 6.1	– 1.4
Taiwan	32.9	31.9	61.7	1.79	6,471.4	+ 1.5	– 1.2	– 1.2
Thailand	37.9	41.2	71.1	5.40	694.1	+ 0.5	– 2.8	+ 5.3
Argentina	3.07	2.86	5.77	10.31	1,714.6	+ 1.7	+ 11.1	+ 9.5
Brazil	2.19	2.32	4.10	14.66	37,288.0	+ 1.9	+ 11.5	+ 19.1
Chile	541	560	1,017	5.04	9,948.8	+ 1.0	+ 8.1	+ 2.2
Colombia	2,426	2,309	4,557	6.74	9,008.6	+ 4.5	– 5.3	– 10.8
Mexico	11.0	10.6	20.6	7.05	20,145.1	+ 1.2	+ 13.2	+ 9.9
Peru	3.24	3.25	6.09	4.50	8,938.3	+ 1.5	+ 86.1	+ 96.9
Venezuela	2,633§	2,607§	4,945	10.16	34,333.7	– 0.1	+ 68.3	+ 65.4
Egypt	5.74	5.78	10.79	8.85	50,367.8	+ 6.3	– 9.0	– 9.1
Israel	4.40	4.49	8.26	5.67	822.2	+ 3.8	– 0.7	+ 3.9
Saudi Arabia	3.75	3.75	7.04	5.22	10,761.3	+ 3.5	– 35.6	– 35.6
South Africa	6.87	6.45	12.9	8.05	20,778.1	+ 1.3	+ 14.8	+ 6.1
Czech Republic	22.2	24.2	41.8	2.37	1,434.4	+ 6.7	– 2.6	+ 7.8
Hungary	213	198	399	7.04	22,205.7	+ 2.1	+ 6.8	+ 7.5
Poland	3.07	3.31	5.76	4.20	44,735.7	+ 0.7	+ 25.7	+ 33.5
Russia	26.8	28.5	50.3	11.50	1,569.9‡	+ 3.9	+ 29.9	+ 39.5
Turkey	1.50	1.31	2.81	20.10	35,721.6	– 0.7	– 10.2	– 18.9
EM (MSCI)*	1.00	1.00	1.88	na	756.1	+ 2.1	+ 7.0	+ 7.0
EMBI+†	1.00	1.00	1.88	na	380.6	+ 0.8	+ 3.2	+ 3.2

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Trading market value.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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